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THE FEDERAL RESERVE SYSTEM

ITS ORIGIN AND GROWTH

Reflections and Recollections

BY

PAUL M. WARBURG

In Two Volumes

VOLUME ONE

NEW YORK

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1930

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SET UP AND ELECTROTYPED BY THE LANCASTER PRESS, INC.
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TO THE GUARDIANS

OF THE

FEDERAL RESERVE SYSTEM

PAST, PRESENT, AND FUTURE

THIS BOOK IS DEDICATED

PREFACE

The first draft of this book was prepared at Pasadena in February and March of 1927. I had gone to California for a three months' rest when the appearance of a series of articles written by Senator Glass (subsequently published in book form under the title "An Adventure in Constructive Finance") impelled me to lay down in black and white my recollections of certain events in the history of banking reform. As this chronicle of the past gradually took form, these recollections gave rise to reflections upon the Reserve System's present state and its future. In this way the preliminary draft took shape and in its essential parts and structure became the basis of the present work. It was some time, however, before I definitely resolved to publish the manuscript and, even after coming to such a decision, I found myself, during the preparation of the final draft, under the strain of highly conflicting emotions. The impulse to correct misinformation and not to withhold material that possibly might prove of service to the public interest clashed with a strong distaste for allowing myself to be drawn into a discussion of phases in our banking history in which I had played an active part. Friends, however, whose unbiased counsel I sought and who were good enough to read the manuscript, gave it as their considered opinion that under prevailing circumstances it was my duty to complete the work, no matter how trying the task. A year went by in the futile attempt to finish the book in the midst of the pressing duties of an active business life in New York. But a second stay at Pasadena, in the spring of 1928, enabled me to bring it to a close. My reluctance, however, to publishing it still continued until, in the autumn of that year, I became

convinced that the Federal Reserve System had entered upon a gravely critical period in its career, and that for the discussion about to ensue it was highly important that certain vital facts in the origin and growth of the System be adequately understood.

When I realized that it had become imperative for me to write this book my first impulse was to seek the collaboration of some of my former associates in the Federal Reserve organization. Regretfully, however, I reached the conclusion that I might ill serve these friends, and the System itself, were I to permit anyone officially connected with its administration to become involved in a public discussion of its present structure and functioning. In order to avoid exposing them to the charge of being in sympathy with or responsible for any statements contained in this book, I finally, and most reluctantly, went to the very extreme of foregoing to mention by name even one-time fellows-at-arms to whom I longed to pay a word of tribute for the splendid services they had rendered the country and of personal gratitude for the friendship and inspiration they had given me.

One of the best among these, Governor Benjamin Strong of the Federal Reserve Bank of New York, has died since this book was completed. I could not inscribe his name upon these pages while he was living. Yet, now that he has gone, I may safely confess that while writing these chapters, his picture often stood before my eyes as the prototype of splendid men who, with utter disregard of self, give their lives and souls to the task of making our Federal Reserve System an efficiently and harmoniously functioning organization,—a heartbreaking undertaking under a law that, structurally, pits against one another forces which should be united in a common effort towards a common aim.

On the occasion of Governor Strong's death it was my privilege to present a resolution in which—inadequately indeed—I attempted to express his fellow-citizens' appreciation of the

part he had played in aiding America to do justice to her new opportunities and duties as a financial power. A reprint of this resolution appears at the close of Volume Two.

Beside the name of Benjamin Strong I should like to place that of David C. Wills, Federal Reserve Agent of Cleveland, and for a brief period a member of the Federal Reserve Board. Mr. Wills died in 1925 at the early age of 53 years. In both cases, careers of extraordinary usefulness might have been prolonged if a complete devotion to the service of the System had not led these men to a ruthless neglect of their duties towards themselves. The fact that it was my privilege to persuade them both to become officers of the Federal Reserve System at the time of its organization may justify my wish to do homage to their memory in these opening pages.

Aside from the inclusion of the above-named resolution commemorating Governor Strong, the addition of a post-scriptum dealing with the stock exchange panic of 1929, and a few footnotes here and there, the manuscript has been left substantially unchanged as it stood in the spring of 1928.

It is hoped that the array of two heavy volumes will not frighten the reader. My story in itself is fairly brief, but it is substantiated by the evidence of a collection of documents which have been placed in the Appendix to Volume One. Volume Two contains essays written by me since 1906. The first part of that volume consists of articles composed before I joined the Federal Reserve Board in 1914, while the second part contains writings published since then. These documents have been reassembled here, because most of them are either out of print to-day or have become so scattered that they are likely to be known only from haphazard quotations in the books of other authors—quotations which are often entirely misleading without the proper knowledge of their context.

No one who for a period of over twenty years has had the temerity periodically to commit himself to print may hope that a complete record of his writings will not demonstrate him as

having, at times, been gravely mistaken. For the historian, however, it is just as important to ascertain what at given periods human minds did not know as what they believed they knew. Man's fight against his own ignorance and against that of his neighbors constitutes one of the most instructive chapters in the annals of human progress. From this standpoint—of tracing the evolution of thinking in the realm of banking reform—a fairly complete record of the author's efforts covering so wide a period may not be entirely uninteresting for a coming generation of students.

I cannot adequately express the depth of my obligation to those whom I found willing to read the manuscript. It ought to be distinctly understood, however, that their generosity in giving me the advantage of their counsel must not be construed as an endorsement of any statements contained in these pages. I may mention only my friends of Pasadena, Robert S. Lovett, Professor William B. Munro, John Perrin, and Henry M. Robinson; furthermore, Professor Edwin R. A. Seligman and Victor Morawetz of New York, Professor William T. Foster of Cambridge, Mass., Professor Harold L. Reed of Cornell University, and, last but not least, my most patient critic and friend, my wife. To Professor Seligman, who from the days of my first literary endeavors has always aided me by his willingness to give a critical reading to my writings, I am particularly indebted for introducing to me Mr. R. W. Robey of Columbia University who, together with my indefatigable secretaries, Miss Margaret Habrich and Miss Ingegerd Nissen, has given me invaluable assistance in the final composition of the manuscript. For preparing the index and seeing the volumes through the press I am obliged to Mr. M. L. Jacobson, Statistician of the Federal Reserve Board from 1914 to 1924.

I wish to extend my sincere thanks to The New York Times, the Academy of Political Science, New York, the Columbia University Press, the American Economic Association, the

Commercial and Financial Chronicle, New York, the North American Review Publishing Co., New York, the Journal of Commerce, New York, and the American Academy of Political and Social Science, Philadelphia, Pa., for their courteous permission to reprint articles of mine previously published by them.

PAUL M. WARBURG

NEW YORK,
January, 1930.

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PART ONE

INTRODUCTION

Nisi utile est quod facimus, stulta est gloria.
(PHAEDRUS)

In an article entitled "The Money Power in Politics," [1] Professor William B. Munro makes the following remarks on the process of law making:

> I am told that Congress and the State Legislatures make the laws. . . . Instead of saying that legislators make the laws, it would be far more correct to say that legislatures merely put the finishing touches on the law. To say that they "make the laws" is like saying that the books are made by bookbinders, forgetting that there are authors, printers, and proofreaders too.
>
> The motive power in lawmaking is all supplied from somewhere outside the legislative halls. . . . Some intellect outside the realm of active politics first conceives an idea. It spreads to the minds of other individuals, slowly at first, but gradually gaining momentum. Presently there is an organized movement in its favor; then comes the deluge of propaganda, until the proposal becomes an issue and the politicians begin to take note of it. A law is half made, and more than half made, when a large body of aggressive support has been mobilized among the voters; yet during this part of the process the legislative bodies have nothing whatever to do with it.

No one conversant with the history of the Federal Reserve Act is likely to read this passage without noticing how closely it applies to the origin of that measure. The ideas so succinctly stated by Professor Munro seem not to have occurred, however, to the principal commentators on the origin of the Federal Reserve System. As a rule, these writers have treated the technical work of framing the law, the debates in committees and on the floors of Congress, and the incidents relating thereto, as the chief matters of his-

[1] *Atlantic Monthly*, April, 1927, p. 447.

torical importance, indeed, as though they were the whole drama. To the period, on the other hand, during which the basic ideas crystallized and during which public opinion was mobilized in their support—the period which constituted not only the prologue but also the first act of the drama—they have given very scant and inadequate consideration. Yet the way a law looks when it is "half made, and more than half made," deserves close study; for in this stage, if it is the result of the labors of men uninfluenced by selfish motives, it represents, as nearly as may be possible, the law in its ideal form. It is the neutral model of a non-partisan proposal untainted by political considerations. In order, however, that a proposed bill may be placed upon the statute book, it is its inevitable fate to become the subject of political and often of partisan action. A parliamentary government cannot function effectually without a party system. Parties, in turn, are bound by traditions, platforms, slogans, and, most of all, by the fear of opposing factions. A model law, of sufficient importance to be considered as coming within the ominous circle of party politics, is bound, therefore, to lose its neutral character and to be remodelled so as to harmonize with the tenets of the party that undertakes to enact it. Thus the labors of parliaments may result in deplorable perversions of the original non-partisan proposals by dint of concessions to the right side or the left, depending upon the particular party which happens to be in power. And the more difficult it be to muster the necessary majority, the heavier must be the toll of concessions to extreme wings whose votes must be secured. Compromises thus are the frequent fruits of parliamentary law making.

In spite of such handicaps, however, a law enacted in such circumstances may denote great progress and, for a while at least, confer benefits of the highest order. But as time progresses and as the economic structure based on such legal groundwork grows in height and weight, the weakness of the

very foundation will be revealed whenever sound principles and convictions were compromised.

Fortunately, in a world of constant evolution, public opinion advances and, as time loosens the stranglehold of prejudices and party commitments, the "political necessities" of yesterday cease to exercise their sway. Ever-changing economic and psychological conditions call for the adaptation of old laws to new circumstances; and defects in a law which had to be accepted as the price of its enactment may subsequently be corrected with comparative ease. The law in a process of gradual evolution may thus lose its partisan color and adopt a form more closely approximating the original non-partisan model.

A comprehensive scientific account of the origin and development of the Federal Reserve Act would have to record some such evolution. The first part of such a history should start with an analysis of the soil in which the early beginnings of the neutral law had its roots. It would then trace that model through its first stages of development, describe the gradual spread of the movement for its propagation, and show how the propaganda gained momentum and assumed an organized form.

The second part of the story—tne part devoted to parliamentary recognition of changed public opinion—would depict Senator Aldrich's entrance upon the scene, his assumption of the leadership in the banking reform movement by the presentation of the National Reserve Association Bill, a bill which may be regarded as the Republican version of the neutral model. The educational campaign carried on by the National Citizens' League would fill an essential chapter of this part of the story, which would end with the failure of the Aldrich Plan. Thenceforth, this stage of the analysis would deal with the ascendency of the Democratic party and with its crowning accomplishment in banking reform, the enactment of the Federal Reserve legislation.

The third part would reveal the law in operation. It would show where practical experience led Congress to remove some of the undesirable features forced into the law either by political considerations or by faulty estimates of future needs, and would indicate where errors still remain to be corrected if the System's future is not to be impaired.

Ever since 1914 I had hoped for a comprehensive history of this kind. Unfortunately, however, while we have several excellent books treating the operations of the Federal Reserve System since its organization,[1] the most important if not the only books dealing with the genesis of the Federal Reserve Act are those of Senator Glass, Dr. H. Parker Willis, and Senator Robert L. Owen, all of them the productions of pleaders in their own cause and not of unbiased historians. These writers fail to give an adequate account of the work done by individuals and associations in the period extending from 1908 to 1914, and particularly of the important contributions made by Senator Aldrich. Some of them, indeed, have gone to the extreme of making determined efforts to disprove any direct relationship between the Federal Reserve Act and the Aldrich Bill.

Thus the true connection between the half-made law, as Professor Munro puts it, and its outgrowth, the Federal Reserve Act, has yet to be fully described and justly appraised. It is of the utmost importance that this connection should be established, for without an adequate knowledge of the origin and evolution of the Act we cannot understand the present problems of the Federal Reserve System nor wisely determine

[1] Harding, William P. G. *Formative Period of the Federal Reserve System (During the World Crisis)*, 1925, Houghton, Mifflin and Company; Kemmerer, Edwin White, *A B C of the Federal Reserve System*, Princeton University Press; Reed, Harold Lyle, *Development of Federal Reserve Policy*, 1922, Houghton, Mifflin and Company; Burgess, Warren Randolph, *Reserve Banks and the Money Market*, 1927, Harper and Brothers; Goldenweiser, E. A., *Federal Reserve System in Operation*, 1925, McGraw-Hill Book Company.

what changes should be made in the law or in the methods of its administration.

An equitable assessment and frank acknowledgement of Senator Aldrich's work is further necessary for the special reason that unless the System be considered the child and ward of both parties its future is not secure. If, from time to time, the needs of the Reserve System are to be dealt with by Congress in a spirit of disinterested sympathy, if Congress is to place the Reserve System in a position of unassailable authority and to safeguard it from political interference, the Reserve System must have the undivided friendship and goodwill of both political parties. It is imperative that it should be regarded not as the work of a single party, but as the product of the combined efforts of all those who helped to bring it about and as the property of all the people.

Moreover, it is dangerous to permit misinformation to remain for long unrefuted. Miss Clio, the Muse of History, is a stubborn lady, entirely devoid of a sense of humor, and once she has made up her mind, it is exasperatingly difficult to alter her verdict. It is inadvisable, therefore, to delay too long the correction of inaccuracies, particularly in cases where silence might fairly be construed as assent.

Finally, the Reserve System does not stand still. Its problems are immediate, and legislative action may be invoked at any time. When the hour for action by Congress does arrive, it is of the utmost importance that the problem be taken up in the fullest knowledge of the true facts and without partisan bias.

Considerations such as these were uppermost in my mind when I reached the conclusion that it was my duty to venture upon the difficult and in many respects unwelcome task of writing this book. It ought to be understood, however, that I do not present it as a chapter of banking history, or as a complete story of the struggle of the non-political thought in banking reform. It would have been impossible for me to attempt

to cover the many contemporaneous efforts made by others striving for the same goal; I could give a description only of the episodes of the play in which I personally took part either as actor or as spectator. I could offer such a sketch only with the very distinct and limited aim in mind of contributing building material which some day might be useful to historians who, in chronicling the genesis and evolution of the Federal Reserve Act, would seek to fill in the gaps and throw new light upon phases of the drama which have been incorrectly presented, or have remained obscure.

In order to avoid any misunderstanding, may I be permitted to state at the outset that I do not claim to have originated any new banking principle. I was trained in the practices of a banking system which under varying forms had worked satisfactorily in almost every industrially advanced country, except the United States. From the time of my arrival in America I felt impelled to urge the adoption of the fundamental principles upon which that established and proven system was based, and by submitting several plans I tried to demonstrate the possibility of a practical adaptation of this system to American conditions. It was owing to the interest I had shown in banking reform that, when the Aldrich Banking and Currency Committee was appointed, I was invited to assist it in formulating a plan providing for the creation of a Central Reserve Association with regional branches. I had opposed plans envisaging systems of large numbers of divisional reserve banks entirely disconnected from one another, but I favored plans providing for a moderate number of regional banks intimately connected with one another so as to constitute a properly coördinated central banking system. Hence, when subsequently a bill was introduced in Congress for the creation of a system of regional reserve banks tied together by a central board, instead of one reserve bank with regional branches, I endeavored, just as I had done in the case of the Aldrich Bill, by positive and negative recommendations, to

keep the Act, a highly desirable project, from being jeopardized by dangerous concessions to extreme political demands. When the Federal Reserve Act was passed, and I became a member of the Federal Reserve Board, I continued, hand in hand with others devoted to the same task, to work for the successful development of the Federal Reserve System by pressing for amendments as practical experience in operation rendered them necessary and possible. In this work I was at all times an opponent of the political view, championing the non-political side, and it is in that spirit that as a final effort I now present this book.

In the first part of the book the form of a personal narrative has been adopted, because by this method it proved possible to establish authentically the chronological record of events, often in refutation of assertions made by others, without tiring the reader by specifically mentioning in each instance the statements to be disproved. Where it was important to leave no doubt as to the nature of the case involved the passages relating to these statements have been quoted.

While I do not deny that, having devoted the best part of my life to the solution of our banking problem, I am anxious to keep the record of my work clear and undistorted, the main object of this book does not lie in that direction. My narrative is but the background for the conclusions to be drawn therefrom. "Recollections and Reflections" serve only to show that the Federal Reserve Act—one of the greatest accomplishments ever recorded in the annals of Congress, an Act conferring untold benefits not only upon the United States but upon the entire world—is still weighed down with the burden of political compromises which menace its future; that this danger could be removed without affecting any fundamental part of the structure, but that the necessary remedial action may be hoped for only if the problem can be dealt with in a thoroughly non-partisan spirit.

The principal message of this book thus remains that the

Reserve System is the product of the labors of many minds, that it is the common property and ward of all the people, and that all must feel an equal degree of concern and responsibility for its welfare. In order to be accorded its proper place, the Reserve System must be looked upon as a national monument, like the old cathedrals of Europe, which were the work of many generations and of many masters, and are treasured as symbols of national achievement. Because Bramante conceived, Rafael Sanzio elaborated, and Michael Angelo carried out, the Cathedral of St. Peter's at Rome, this monument of their combined genius, is all the more cherished by the people of Italy as one of their most sacred possessions.

If this narrative should help to awaken in the minds of its readers a like attitude toward the Federal Reserve System, the author's aim will have been accomplished.

CHAPTER I

FIRST ATTEMPTS AT BANKING REFORM

(1903–1908)

WHEN the full history of the Federal Reserve Act comes to be written, it is to be hoped that in addition to a complete description of the banking laws and conditions prevailing in the United States in the last decade of the nineteenth century, it will contain a careful account of the state of mind of the people of that time concerning the broad problem of money and banking.

Without a clear comprehension of the attitude of the business men, bankers, and economists of that period, coming generations will find it impossible to visualize the obstacles which had to be overcome and to gauge the distance which had to be covered, when the way was blasted for the gradual advance and ultimate victory of banking reform.

Such a history, however, must be penned by others. I cannot do more here than attempt to sketch the rough outlines of the picture of men and conditions as I saw them when, after several visits to the United States, I moved from the Old World to the New, and settled in New York as a banker in the fall of 1902.

At that time there were in existence some twenty thousand national and state banks, stock savings banks, private banks, and loan and trust companies, of which about one-half had a capital of $25,000 or less. There were about five thousand national banks, the largest of which had a capital of $25,000,000, a surplus of $8,900,000, and deposits of $138,000,000. The largest state banking institution had a capital of $2,000,000, a surplus of $2,500,000, and deposits of $34,000,000. There was no organic cohesion between these approximately

twenty thousand banks. Individualism in banking was the gospel of the country. The view was generally held that centralization of banking would inevitably result in one of two alternatives: either complete governmental control, which meant politics in banking, or control by "Wall Street," which meant banking in politics. Abhorrence of both extremes had led to an almost fanatic conviction that the only hope of keeping the country's credit system independent was to be sought in complete decentralization of banking. As a consequence, there existed as many disconnected banking systems as there were States, and even among the banks of a single State there was no machinery for mutual protection except the "clearing-house associations." These organizations were to be found, however, in only a comparatively small number of localities and, even within their restricted areas, served—rather ineffectively at that—to assist their bank members in times of grave financial convulsions, rather than to prevent the occurrence of such calamities.

The National Bank Act had been devised in order to create a uniform though strictly decentralized credit system, with a decentralized inelastic note issue secured by the deposit of collateral consisting of certain United States Government bonds. Under this plan a system of obligatory individual "reserves" was relied upon to limit the possible extent of credit and deposit expansion. Taking account of the various types of banks, the Act divided national banks into three classes, viz., central reserve city banks, reserve city banks, and country banks; and for each class it stipulated a different "required reserve." Country banks were to maintain against their demand deposits a reserve of 15 per cent, of which not less than 6 per cent was to be held in lawful money in their own vaults, and 9 per cent could be redeposited with other national banks acting as "reserve agents" in reserve or central reserve cities. National banks in reserve cities were to maintain a reserve of 25 per cent, of which not less than half was to be kept in lawful money in their own

vaults, while the other half might be redeposited with "reserve agents" in central reserve cities. National banks in central reserve cities, that is, in New York, Chicago, and St. Louis, had to maintain a reserve of 25 per cent, all of which was to be kept in lawful money in their own vaults. A number of State laws had copied the National Bank Act in dividing their state banks and trust companies into similar classes, requiring them to maintain similar cash reserves against deposits and granting them similar authority to redeposit a portion of their required reserves with "reserve" and "central reserve agents." Indeed, certain States permitted their institutions to include national bank notes in the cash reserve to be kept in their vaults. Thus national and State legislatures had combined to create a system of pyramided reserves—a system which was bound to produce an artificial and unhealthy concentration of funds in the reserve and central reserve cities, and particularly in New York. Reserve funds need not inevitably have accumulated in New York to any larger extent than in Chicago and St. Louis, had not the call-loan market of the New York Stock Exchange proved the only reliable money reservoir in which reserve funds in vast amounts could be easily placed, and from which—as long as things remained normal—these funds could be withdrawn at the pleasure and convenience of the lender. It should be remembered, in this connection, that in those days commercial paper in the portfolios of the banks, instead of being a liquid asset, constituted a lock-up of funds and that there was no free supply of, or wide market in, United States Government securities. The only government bonds normally available were those that could be used as collateral for the issue of national bank circulation, and these had been absorbed and were firmly held by the national banks and commanded a fancy price.

The settlement of balances between cities was entirely in the hands of the commercial banks, which maintained elaborate

check collection departments. "Transfers," in so far as they were not accomplished by shipments of actual currency, were generally effected by buying or selling "exchange," and "collection and exchange charges" played a very important part in the banks' daily routine and — particularly in the case of the smaller banks — furnished a substantial portion of their revenues.

If industrial conditions had not undergone revolutionary changes, this host of self-centered local banks might not have proved so inadequate. But when the country outgrew its provincialism; when our new industries started upon their phenomenal careers; when a lively and intimate daily exchange of goods and funds began to develop, not only between the several sections of the country, but between ourselves and all the rest of the world, the national banking system, with the state banking system superimposed upon it, was bound to show the fatal consequences of its inadequate structure.

It became painfully manifest that extreme individualism in banking had rendered the country incapable of coping with its growing requirements and had made it hopelessly defenseless against dangers both from within and from without. If gold was withdrawn for export, the bulk of it could only be taken from the cash holdings of the bank which made the shipment, or indirectly from some other institution. If the bank losing gold strove to regain it by calling in some of its demand loans—collecting in lawful money the balance thus made available to it in the daily clearing-house settlement—some other bank of necessity had to be the loser of a corresponding amount of reserve money. As long as all the banks collectively commanded reserves well in excess of the legal requirements, these adjustments could take place without creating difficulties or alarm. But when heavy demands for gold from abroad, or excessive domestic demands for circulation, or an abnormal increase of bank loans and bank deposits had brought excess reserves down to or below the legal requirements, financial conditions became at once critical.

Without a central organization, which by discounting or buying commercial paper could furnish additional currency or additional reserves, a heavy rise in deposits or a marked increase in the volume of circulation were bound automatically to tie up the banks. It is true that a certain elasticity was provided by the willingness of European bankers to grant us acceptance credits. These credits served to finance the movement of our crops and, in the form of finance bills, to provide for the additional demands of industry and speculation. But when these credits became exhausted, the mere knowledge that the end of the tether had been reached created a situation of such tenseness that even a slight shock could cause the collapse of the insecure structure. When, in such circumstances, Europe would attempt to curtail credits, or draw gold, or when the depositor would become alarmed and begin to hoard it, when the vicious "gold premium" would put in its dreaded appearance—pandemonium was inevitable. With no central institution to provide relief, nobody could strengthen his position save by attacking his neighbor. Thus natural instincts of self-preservation, when called into play, unavoidably led to panics and wholesale destruction of values. When the frantic attempt to sell securities at any price, while nobody was in a position to buy, precipitated a crash which at times forced the stock exchange to close its doors, stock-exchange call loans "froze." That meant that the liquid reserves of the banks in all parts of the country had become immobilized and that a general suspension of cash payments was inevitable. Within the confines of a city banks might make efforts to settle at least the most pressing transactions by accepting clearing-house certificates in settlement with one another. Outside of this narrow circle, however, payments between cities and sections entirely ceased, as banks refused to ship currency and declined to accept payments in checks on other cities. It was one of the tragic defects of the American banking system at that time that,

while disasters of this kind were the automatic consequences of over-expansion, there was no possibility of averting them by timely preventive collective action. There was no governmental or private authority that could assume leadership in warning the country, or that had actual power to put on the brakes if the car were moving too fast and heading for the precipice.

Individualism in banking demanded that everybody should be free to have his own individual fling, while the subsequent disaster was the common property of all, engulfing the innocent with the guilty. At times, when excesses had not gone too far, the unwillingness and inability of the banks to make further loans—which might express itself in interest charges of from 50 per cent to 100 per cent for call loans—would bring about a contraction; at times, the very existence of such rates would tend to broadcast the critical underlying conditions and precipitate the panic that it was hoped such prohibitive rates would forestall. Everybody will agree to-day that it would be difficult to imagine a banking system more cruel and more inefficient than that prevailing in the United States at the beginning of the twentieth century—a system which, instead of scientifically regulating the flow of credit and money so as to secure the greatest possible stability, was designed automatically to produce instability; a system which permitted expansion and contraction to go unhampered to their very extremes; a system which knew no better way to turn the ebbing tide of credit than to lay the country waste, making its ruins an attractive shopping place for domestic and foreign wreckers and bargain hunters.

It is very important, however, to realize how little the people of that period understood the fundamental organic defects of their banking system. American public opinion was strongly inclined to dispose of the question by laying the blame for these difficulties upon the "selfish and reckless management of corporations," on "over-speculation," the "greed of banks," or the wily practices of "Wall Street."

To a person trained under the central banking system of European countries, such conditions seemed bewildering and strange. To him American banking methods appeared to do violence to almost every banking tenet held sacred in the Old World. In Europe, reserves were centralized, note issues were elastic, and commercial paper permitting of immediate sale formed the quickest asset of the banks. In Europe, the "bill market" formed the most important field in which banks sought to employ their liquid funds, while a certain limited portion of their secondary reserves was invested on the stock exchanges in fortnightly or monthly loans under the term-settlement system generally prevailing on European stock exchanges, instead of a daily-settlement system such as that in vogue with us. In the United States, the note issue, based on government bonds, was inelastic, gold reserves were decentralized, and investments in unsalable single-name commercial paper were locking up the funds of the banks, while call loans on the stock exchange constituted their chief liquid asset.

The idea of a central banking system being anathema to all, attempts to obtain relief generally centered in proposals for the creation of more currency to be issued by thousands of individual banks. What the general state of mind was with regard to the banking problem may well be illustrated by a conversation I had shortly after my arrival.

In order to clarify the problem as it had arisen in my mind, I had ventured to set down, in a short memorandum, the cardinal defects of our system as I saw them. I compared our methods with those employed in Europe and pointed out the direction in which, I believed, the remedy might be found. I stressed the fact, however, that, aside from psychological and political resistance, any attempt to establish in the United States a banking system more nearly approaching the European models would meet a serious and almost insuperable obstacle in the fact that, while central banking systems in Europe were largely built upon a foundation of modern

commercial paper and bankers' acceptances, these modern forms of paper were then non-existent in the United States, and that, therefore, progress could be achieved only by slow degrees.

This memorandum was shown to Mr. Jacob H. Schiff, then the senior partner of the banking firm of Kuhn, Loeb & Company, of which I had lately become a member. Mr. Schiff read the paper with interest and told me, what afterwards he often repeated, that, while theoretically he agreed with most of the thoughts expressed, he believed that I was misjudging the psychology of the American people, who would never, he said, accept any system approaching a central bank. But since he always appreciated earnest efforts on the part of his juniors and never missed an opportunity of encouraging them, he suggested that I let him show the paper confidentially to two of his friends. One of these was Mr. James A. Stillman, President of the National City Bank of New York. It was significant, however, of the atmosphere in which we were then living that Mr. Schiff warned me to be careful not to have the memorandum go any further, lest, having just arrived from Europe, I might impair my standing in the banking community by creating the impression that I was urging a system which, in the final analysis, would have to be built around a central banking organization. I gladly accepted Mr. Schiff's suggestion, and a few days afterwards I found Mr. Stillman standing over my desk. He looked at me silently, as was his wont, through his half-closed, heavy dark eyes.

"How is the great international financier?" he asked with friendly sarcasm. He then added, "Warburg, don't you think the City Bank has done pretty well?"

I replied, "Yes, Mr. Stillman, extraordinarily well."

He then said, "Why not leave things alone?"

It was not without hesitation that I replied, "Your bank is so big and so powerful, Mr. Stillman, that, when the next

panic comes, you will wish your responsibilities were smaller."

At this, Mr. Stillman told me that I was entirely wrong, that I had the mistaken notion that Europe's banking methods were the most advanced, while, as a matter of fact, American methods represented an improvement upon, and an evolution of, the European system, America having already discarded its central bank. He had no doubt that progress would have to be sought, not by copying European methods, but by elaborating our own.

Four years later, in the midst of the panic, I found Mr. Stillman once more standing over my desk; and when I looked up, he asked, "Warburg, where is your paper?"

I said to him, "Too late now, Mr. Stillman. What has to be done cannot be done in a hurry. If reform is to be secured, it will take years of educational work to bring it about."

This incident is related for the sole purpose of showing the status of banking and business opinion in those far-off days. What Mr. Stillman had said was typical of the general attitude then prevailing.

At this juncture, the United States Senate was dominated by the Republican "Old Guard," of which Senator Aldrich was the all-powerful head. This group believed in bond-secured currency and, at a pinch, in still more bond-secured currency. In times of emergency, further relief was to come from Treasury deposits, as long as they were available (the government borrowing as far as it had the power to do so). As a last resort, when panic was imminent, or had actually set in, clearing-house certificates were to be issued.

There were other groups in Congress which advocated so-called "asset-currency" plans. Representatives of this school of thought were moving on sound lines, when proposing to make commercial assets the basis of circulation. They were preaching unsound doctrines, however, when they urged that individual commercial banks should be authorized to issue notes against their own assets, and that they should be per-

mitted to do so without providing a safe machinery for securing such notes and redeeming them in gold. Under such plans the weakest bank would have been allowed to put its notes into circulation alongside the strongest, and proposals for the guarantee of deposits were the logical corollary of such schemes (*Fowler Plan*). It is an amazing fact that commercial organizations and bankers' associations of that time favored such asset-currency plans in one form or another.

To complete the picture, it ought to be added that there was also at that time a powerful faction in Congress which stood for the theory that "the issue of money is the function of the government," and only a few years had elapsed since the champions of free silver had alarmed the world by their sixteen-to-one proposal.

After its first glimpse of daylight, my initial memorandum, like a ground hog, went back into the still darkness of my desk until, when banking conditions looked very critical, at the close of 1906, I was invited to write an article for *The New York Times*. I then elaborated the ideas I had expressed in my memorandum and, in its revised form, the article was published on January 6th, 1907, under the title "Defects and Needs of our Banking System." [1] The article was primarily an argument for the creation of modern American double-name paper, a discount market, a central note-issuing organization, and an appeal to bankers to coöperate, at least to the extent of modernizing their conceptions with respect to accepting and endorsing. It also contained an argument urging the consideration of term settlements on the New York Stock Exchange, in order to discontinue the excessive use of the country's surplus funds on the stock exchange's call-loan mar-

[1] *Defects and Needs of Our Banking System*, The New York Times Annual Financial Review, January 6th, 1907; *Essays on Banking Reform in the United States*, Proceedings of the Academy of Political Science in the City of New York, Vol. IV, No. 4. See also Volume Two, p. 9.

ket and to deflect a substantial portion of these funds into a discount market.

In connection with a suggestion for the creation of a uniform issue of bank notes against the deposit of legitimate commercial paper, the following thought was expressed:

> Certain committees would have to be appointed in every reserve and central reserve city in order to scrutinize the bills deposited as security by the banks. *These committees might be the predecessors of future local committees of a central organization.*

To attempt to give an adequate description of the panic which occurred in 1907 would lead us too far afield. October of that year, with the weeks of slaughter and despair following the failure of the Knickerbocker Trust Company and the run on the Trust Company of America, will always remain vivid in my mind. Banks and individuals with hundreds of millions in call loans at their disposal could not save those that were drowning. As already mentioned, without a central reserve organization and without an elastic note issue, one bank could only strengthen itself by weakening another, and any attempt to call in funds from a debtor would only throw him into desperate confusion and set in motion a chain of further embarrassments and insolvencies.

In the midst of the panic, on November 12th, 1907, when the gold premium was at its highest, and when all possibilities of making settlements between cities had ceased, I published a paper entitled "A Plan for a Modified Central Bank." [1] In this paper, it was proposed to create a bank at Washington, endowed with a capital of from $50,000,000 to $100,000,000, partly paid up, and to be owned, one-half by the government, and one-half by the national banks.

[1] *A Plan for a Modified Central Bank, Essays on Banking Reform in the United States*, Proceedings of the Academy of Political Science in the City of New York, Vol. IV, No. 4. See also Volume Two, p. 29.

The management was to be in the hands of a salaried president or presidents, to be appointed by the board of directors; the board itself was to consist of delegates from the various clearing houses, the Secretary of the Treasury, the Comptroller of the Currency, both *ex officio*, and some additional directors to be appointed by the stockholders and by the chambers of commerce and the Supreme Court (the latter suggestion rather an evidence of my insufficient acquaintance, at that time, with these American institutions). The object in mind, however, is clearly shown in the following paragraph:

> It is intended merely to show how it is possible to create a board which would be independent of politics, which would comprise men of business knowledge and experience, and which, by its composition, would afford a reasonable guarantee that it would not be swayed by selfish motives in its actions.

The proposed bank was to establish a general rate of interest, to be modified from time to time, at which it would allow advances of money against clearing-house certificates. There were also provisions enabling the bank to buy three months' paper, bearing at least three signatures, payable in dollars or in certain foreign currencies. Authority for the government bank to buy three months' paper, bearing at least three signatures, including a bank's or a banker's endorsement or acceptance, it was stated, was needed for the purpose of encouraging the creation of such paper, the lack of which was one of the main causes of the immobilization of the resources of American banks.

The following is a quotation from this "Plan for a Modified Central Bank:"

> The Government Bank would act as the clearing house for the clearing houses.
>
> It is not beyond the bounds of imagination that local boards for branches of the Government Bank in the various cities could be established, taking the clearing-house committee, or

> some members thereof, as a nucleus around which some other independent members might be added. It is also possible that these agencies would receive moneys in one city in order to pay them out in the other. . . .
>
> We need some centralized power to protect us against others and to protect us from ourselves, some power able to provide for the legitimate needs of the country and able at the same time to apply the brakes when the car is moving too fast. . . .
>
> We should aim to transform our commercial paper from a non-liquid asset into the quickest asset of our banks. This change, however, is so far-reaching that it would take years of educational work to carry it out, while relief should come at once. . . . Instead of giving vast and vaguely defined powers, properly belonging to a central bank, to one or two political officers (the Secretary of the Treasury and the Comptroller of the Currency—*Author*) and instead of putting the burden and responsibility on them alone, we should define the power and responsibility clearly and should associate with our political officers in bearing it a large body of our best-trained business men. This would mean a democratic, a conservative, and a modern way of self-government.

In the turmoil of their daily struggles for survival, it was only natural that bankers did not find time to study this plan. Indeed, in that time of panic, they could hardly have been expected to do so. Looking backward to-day, however, it seems that had it been possible to arouse Congress to quick action along the lines proposed, prompt relief might have been secured, and a great deal of trouble might have been prevented.

But as far as the problem of devising remedial financial legislation was concerned, the Senate and the House of Representatives were, at that time, wide apart. The Senate was wedded to Senator Aldrich's proposal for the issue of additional notes against government bonds and other corporate obligations, while the House was endorsing a proposal of the Hon. Charles N. Fowler for an "asset currency"—a proposal

which involved the creation of "currency associations" coupled with a provision for the "guarantee of deposits."

It was inevitable that, after the panic, the general interest in the question of banking reform should become very keen. In January, 1908, under the leadership of Professor Edwin R. A. Seligman, a series of lectures upon the banking problems of the hour was arranged at Columbia University. I was invited to join this forum and delivered an address entitled "American and European Banking Methods and Bank Legislation Compared."[1]

This address dealt with the problems covered in the earlier articles referred to above; but for the first time, the "concentration of reserves" was urged. While one thousand millions of dollars were lying idle in our banks and trust companies as so-called reserves, that is, as the final resort in case of need, this money, by virtue of the law, could scarcely be touched. But what, my audience was asked, was the use of such reserves if they were not available in emergencies and times of need and if, even in contravention of the law, they could not be used by one bank without fear of being ruined, unless all banks agreed to coöperate in using them freely? The inevitable conclusion was emphasized that the road to reform lay in the direction of concentration of reserves, and in the cooperation of the banks under the leadership of one central organization.

Although it is twenty years since this address was delivered at Columbia University, certain passages contained in it may have an interest not altogether outworn, as, for instance, the following:

> We cannot have an effective modern central bank, because there are no modern American bills of exchange, and we cannot

[1] *American and European Banking Methods and Bank Legislation Compared. The Currency Problem and the Present Financial Situation,* Columbia University Press, 1908; *Essays on Banking Reform in the United States,* Proceedings of the Academy of Political Science in the City of New York, Vol. IV, No. 4. See also Volume Two, p. 39.

create a sufficient amount of modern paper without a central bank. We cannot have stock-exchange settlements without the abolition of the usury law; but even after its abolition we must have a bill market before we can do away with daily settlements and call loans, based on these daily transactions. Nevertheless, every one of these changes will have to be effected some day, and it is all-important that each successive step in currency and banking reform be made with this end in view.

From this standpoint it is evident why neither the Aldrich Bill[1] nor the Fowler Bill can be deemed to be a step in the right direction. Every measure is bad (1) which accentuates decentralization of note issue and of reserves; (2) which uses exclusively bonds as a basis for additional circulation; (3) which gives to commercial banks power to issue additional notes against their general assets without restricting them in turn in the scope of their general business, and without creating some additional independent control, endorsement, or guarantee; (4) which gives arbitrary powers exclusively to political officers, often untrained in business, and usually holding office only for a short period.

A central clearing house, with power to issue against clearing-house certificates notes to be guaranteed by the United States, would, in my judgment, form the best solution for the time being. The creation of a central clearing house with a capital of its own and with a limited dividend, the surplus revenue going to the United States, would leave present conditions undisturbed, and, while offering immediate relief, would at the same time form a sound basis for future developments.

It is unnecessary to repeat in detail the arguments for the organization of the central clearing house and the enumeration of its powers which were given in this address.[2]

[1] This "Aldrich Bill" of 1908 must not be confused with the "Aldrich Bill" of 1912 proposing the National Reserve Association legislation.—*Author.*

[2] I thought it best to use the clearing-house organizations as the basis for the first steps towards monetary reform, because the banks were familiar with their operations; and, by choosing the form of a central clearing house, I hoped to avoid the central-bank controversy, which would have involved interminable delays.

This Columbia University address became the subject of a number of editorials and stimulated a good deal of interest among bankers and business men in the problem of remedial financial legislation.

An exchange of letters took place in the spring of 1908 between Mr. Herbert Parsons, Mr. Theodore E. Burton, and myself. Both of these gentlemen were at that time members of the House of Representatives. Some passages from a letter I addressed to Mr. Burton throw light upon the legislation then under discussion.

New York,
March 30th, 1908

The Hon. Theodore E. Burton,
House of Representatives,
Washington, D. C.

Dear Mr. Burton:

According to your desire I have studied the question how to amend the Aldrich Bill so as to embody in the same the clearing-house certificates as a basis for issuing additional circulating notes. . . .

My draft of the bill as it stands now is rather amusing, because one cannot imagine two bills more opposed to each other than the Aldrich and the Fowler Bills, and still by welding both together with comparatively few changes we get a bill which takes away the radical features of both of them and contains enough of both measures so as to make them appear as a compromise to both contending parties. . . .

It would be carrying coals to Newcastle were I to try to tell you why this bill, as suggested, would be superior to the Aldrich Bill, and why it is more conservative than the Fowler Bill, while it retains the good principles of the Fowler Bill of "basing additional currency on commercial assets." What I like about my bill is the fact that it will remain a voluntary act for each bank to join the association and that each guarantee will be given after full examination, and that these guaran-

tees will be well defined and limited, instead of a wholesale guarantee for uncontrolled business.

While I think that a bill of this kind would be a big step in advance, as against the bills proposed by Senator Aldrich and Mr. Fowler, it is to my mind not the ideal bill as it maintains the principle that commercial banks are, at the same time, note-issuing banks, and as it increases this note-issuing power which, once established, it will be difficult to take away again. If the two Houses would take candidly to a scheme as outlined in the enclosed bill, it may perhaps be possible, at the last moment, to go one step further, and create a bank in Washington, the stock of which would, at the beginning, be entirely owned by the government, and let this bank, which can be governed partly by political officers, and partly by business men, issue the notes against the certificates of guarantee, instead of allowing the national banks to issue this ciruclation. The difference, for the time being, is a very small one; but as a stepping stone for the future the importance is immense. It would establish a right principle, and besides such a scheme could *embrace not only national banks but state banks, possibly also trust companies, which would become members of the district associations, while both the Aldrich and the Fowler Bills, no matter how amended, can only deal with national banks.*

Yours very truly,

PAUL M. WARBURG

The legislation under discussion finally took the form of the bill which passed into law as the Aldrich-Vreeland Act. This bill constituted a compromise somewhat on the order of the one discussed in the letter above. It permitted the issuing of emergency currency against the deposit of government—and certain corporate—obligations and of commercial paper guaranteed by certain currency associations to be organized under the authority of the law. Unfortunately, however, Senator Aldrich succeeded in inserting a provision to the effect that national banks, before being permitted to avail themselves of

the privilege of issuing notes against commercial paper, should be required first to take out a certain amount of circulation secured by bonds.

My correspondence with Mr. Burton and with Mr. Parsons finally led me to send Mr. Burton a draft of a bill, in the formulation of which I had the advantage of the collaboration of my late friend, Albert Strauss, who subsequently succeeded me as member of the Federal Reserve Board. This bill was sent to Mr. Burton in pamphlet form and was entitled "A Modified Central Bank of Issue: A Suggestion of a Bill." Accompanying the bill, I sent a letter to Mr. Burton under date of April 30th, 1908 (see Appendix One), asking him to introduce the bill in the House "by courtesy," and he complied with my request.

For convenience, the bill, as introduced by Mr. Burton, has been reprinted in Volume Two.[1] It will be noted that the bill contained the express provisions that balances of member banks with the central bank of issue should be counted as reserves of member banks, and that the notes of the central institution should be counted as reserve money in the hands of the member banks. To the best of my knowledge, these two suggestions were novel at that time.

The pamphlet in which this draft of a bill first appeared contained a preface which gave a synopsis of the provisions of the bill and which stated certain facts and fundamental principles to be recognized in dealing with the question. They were:

First, that the United States must finally develop some kind of a central bank system, giving the country an elastic currency payable in gold and based on modern commercial bills, a system similar in principle, if not exactly alike in form, to those of the important European central banks.

Second, that, while this must be the final aim, our political,

[1] *A Modified Central Bank of Issue: A Suggestion of a Bill,* New York, 1908. Volume Two, p. 71.

legal, and economic conditions preclude the possibility of creating an institution with powers and efficiency equal to those of the European government banks.

Third, that, therefore, we shall have to be satisfied to advance slowly, fully realizing that what we create now can only be an initial step. *But it must be a step in the right direction, a measure which has clearly in view the final aim and which does not neglect any of the fundamental principles on which modern central bank systems have been erected in other countries.*

Two passages dealing with the legislative proposals then under discussion may be of interest and are quoted in full:

> No measure is acceptable:
>
> (*a*) Which bases currency on long time obligations, like the Aldrich Bill.
>
> (*b*) Which would tend still further to decentralize the power of issuing notes, and which would vest this power in banks doing a general commercial business. The issuing of notes must be centralized *into a few organs, or, if feasible, into one organ*—a plan, which will insure effective expansion and contraction of currency and concentration of reserves. Such a note-issuing bank, in order to be safe beyond question and in order to provide safeguards against any abuse of its vast power through favoritism or speculation, must be carefully restricted in its scope of business. (That is why we could not accept a bill like the Fowler Bill, which practically would create thirty to forty thousand note-issuing national banks, doing at the same time a general banking business, while the smallest and most speculative bank, through the proposed guarantee of deposits, would be as able to attract large deposits as the largest and most conservative bank. Such a measure, although the very antithesis of the Aldrich Bill, would be quite as much in contravention of well-established economic principles.) A note-issuing bank in this country should be exclusively a bank of the banks.

On the front page was printed President Lincoln's campaign speech at New Salem—for which I was indebted to my friend, the late General James H. Wilson of Wilmington, Delaware—as follows:

> Friends and Fellow-Citizens:
>
> I am plain Abe Lincoln. I have consented to become a candidate for the legislature. My political principles are like the old woman's dance—short and sweet. I believe in a United States Bank; I believe in a protective tariff; I believe in a system of internal improvements, and I am against human slavery. If on that platform you can give me your suffrages, I shall be much obliged. If not, no harm done, and I remain, respectfully yours,
>
> Abe Lincoln.

CHAPTER II

EVOLUTION OF A CENTRAL RESERVE PLAN
(1908–1910)

THE most important paragraph in the Aldrich-Vreeland Bill, enacted on May 30th, 1908, was that which provided for the creation of the Monetary Commission. This Commission, organized under the chairmanship of Senator Nelson W. Aldrich, had for its purpose the making of a thorough investigation of banking methods in other countries and the submitting of a report and recommendations to Congress. My first meeting with Senator Aldrich had taken place on December 26th, 1907. At that time, he held a position of unparalleled power as the Republican party leader in the Senate, which had been almost uninterruptedly under Republican control for over a generation. I had developed a feeling of deep resentment towards him because, whenever the question of banking reform was raised, one was told that so long as Aldrich was in power there was no hope whatever of weaning the country from the system of a bond-secured currency to which he had so strongly committed his party. I met the Senator when he called at our office to secure information about certain practices of the German Reichsbank and particularly about the issue of a certain type of German currency. I availed myself of the opportunity to write to Senator Aldrich on the following day, enclosing a copy of my "Plan for a Modified Central Bank,"[1] providing for the organization of a national clearing house.

This letter was followed up four days later by another in which I took issue with him concerning a plan he must have outlined in the course of our first talk, a scheme which con-

[1] *See* Volume Two, p. 71.

templated granting national banks the power to issue notes against certain clearing-house certificates. I urged the Senator to consider the possibility of organizing a central clearing house which would issue a uniform circulation instead of permitting every individual bank to issue its own notes. The full text of the second letter may be found in Appendix Two.

Whether or not Senator Aldrich ever gave serious consideration to the arguments of my letter or to my Columbia University address, "American and European Banking Methods and Bank Legislation Compared,"[1] a copy of which was sent to him in February, 1908, I have no way of knowing. The proposals he made in connection with the framing of what became the Aldrich-Vreeland Act, and the form in which it was passed in May, 1908, offer convincing proof that I had not succeeded in winning him over to my point of view. On the other hand, we find the following passage in the speech with which Mr. Aldrich introduced the bill in the Senate.[2] Analyzing the several proposals under discussion, he said:

"There is one advocated by many thoughtful students of economic history and teachings, who are led by the experience and practice of other commercial nations to favor some plan for a central bank of issue which would be in effect a central clearing house with very limited banking functions, under government control. Personally, I believe that in time this country is likely to adopt such a system, but I agree with other members of the committee that its adoption at this time, or in the near future, is out of the question."

Looking backward, one would be inclined to conclude from the above that the seeds from which, later on, the "Aldrich Plan" grew had begun to germinate and were struggling to take root.

[1] *See* Volume Two, p. 39.

[2] *Speech of Senator Aldrich of Rhode Island on Senate Bill No. 3023 to amend the National Banking Laws in the United States Senate*, Monday, February 10th, 1908, p. 9.

In the summer of the same year, Senator Aldrich and certain members of the National Monetary Commission sailed for Europe in order to interview the financial authorities of the Old World.

In the meantime, I continued hammering my doctrines into such victims as came my way.

After the panic of 1907, a great many commercial bodies had organized special committees for the purpose of studying the banking problem. In October, 1908, the Merchants' Association of New York invited me to become a member of their Committee on Currency. This Association had, some months earlier, endorsed the current Fowler Bill for an asset currency, and I found the Committee a group of men thoroughly in favor of that scheme. The chairman of this Committee was Mr. Edward D. Page. Later on, he was succeeded by Mr. Irving T. Bush. Professor Joseph French Johnson served as the expert of the Committee. Altogether, the members constituted a very earnest and thoughtful group of merchants; and many an afternoon and night I sat with them, struggling to win them over to the gospel of centralized reserves and elastic note issue, and learning in turn from them in what respects my ideas had to be modified.

On December 14th, 1908, I received from Professor A. Piatt Andrew, Special Assistant to the National Monetary Commission, an invitation to write an article on "The Discount System in Europe," to be included in the series of essays to be published by the Commission. It gave me particular pleasure to comply with this request, because a true picture of the discount system in Europe could not but prove a strong brief for centralized banking. My article was handed in on May 3rd, 1909.[1]

During the Christmas holidays of 1908, I read a paper

[1] *The Discount System in Europe*, Senate Doc. No. 402, 61st Cong., 2d sess., 1910; *Essays on Banking Reform in the United States*, Proceedings of the Academy of Political Science in the City of New York, Vol. IV, No. 4. See also Volume Two, p. 183.

before the American Economic Association entitled "A Central Bank System and the United States of America."[1]

In this address, the field which had already been dealt with in previous articles and speeches was covered once more; but here, for the first time, I ventured to attack the problem of the national bank currency. I proposed an "inverse conversion" to the effect that the 2 per cent government bonds with the circulation privilege should be exchanged for 3 per cent's *without* such privilege.

The suggestion was also made in this address that of the net earnings of the central department only a limited portion should be turned over to the stockholders, while the remainder should be made over to the government with power in the latter to use it for the purpose of gradually increasing the gold cover behind the greenbacks or of retiring them.

The address shows a further evolution of the plan of a central clearing house, as evidenced by the following paragraphs:

"The Central Department of Issue should have the right to ask from time to time that the banks, through the associations, deposit with it a certain proportion of their cash reserves, and the law would have to be amended so as to allow the banks to count as cash their deposits with the Central Department of Issue. . . . I have avoided calling the institution of the future a central bank, because, as proposed here, it is not a central bank. If, instead of the independent currency association, this Central Issue Department were endowed with active branch offices dependent upon the head office, such a name would be correct. No doubt, a central bank with active branch offices would be the more efficient, so far as concerns the controlling of the country's gold, its money rates, and its financial safety. But with our present

[1] *A Central Bank System and the United States of America*, American Economic Association Quarterly, 3d series, Vol. X, No. 1; *Essays on Banking Reform in the United States*, Proceedings of the Academy of Political Science in the City of New York, Vol. IV, No. 4. See also Volume Two, p. 95.

political and financial conditions, it would probably be impossible, and in many respects unsafe, to vest such vast powers and duties in one body."

A conference grew out of this meeting of economists when, in the fall of 1909, a dinner was arranged at the suggestion of Professor Davis R. Dewey, of the Massachusetts Institute of Technology, then the President of the American Economic Association, for a further discussion of the subject. Among those present, I remember, were Professors T. N. Carver, of Harvard University; E. R. A. Seligman, of Columbia University; H. R. Seager, of Columbia University, and J. H. Hollander, of Johns Hopkins University.

From then on, my correspondence with economists became constantly wider;[1] and the "give and take" involved was most helpful in bringing out the positive and negative needs of a plan which was presently to be tested by being subjected to the criticism of a deeply prejudiced public.

It was natural that the radical changes involved in the proposals outlined in my articles should have encountered determined opposition from many quarters. Of the scientific writers, the two most gifted exponents of the anti-central bank doctrine were Professor O. M. W. Sprague, of Harvard, and Mr. Victor Morawetz, of New York. They both had published highly interesting articles in which they had not only criticized the central bank doctrine but had presented important constructive proposals of their own. I undertook to answer these two critics, for by so doing I hoped to meet the entire range of the arguments of those opposed to the adoption of a central bank plan.

An analysis of Mr. Morawetz's and Professor Sprague's arguments and proposals and my reply thereto may be found in an address I delivered before the Finance Forum of the

[1] Later on, the list of my correspondents included Professors F. W. Taussig, of Harvard University; O. M. W. Sprague, of Harvard University; Irving Fisher and Fred Rogers Fairchild of Yale University, and others.

Young Men's Christian Association of New York, March 23rd, 1910, entitled "A United Reserve Bank of the United States."[1]

Shortly after the publication of this address, Professor Sprague changed his point of view, and from time to time published studies very helpful to the further progress of currency reform. Mr. Morawetz also soon abandoned what was then his main proposal, a plan to solve the whole problem solely by regulating the note issue. This regulation was to have been accomplished through the establishment of a central board at Washington, which would have fixed the reserves to be maintained against circulation.[2]

As an alternative suggestion, however, Mr. Morawetz had mentioned, in passing, a system of "divisional banks." This is, to the best of my knowledge, the first time that "regional banks" were proposed. What, at that juncture, Mr. Morawetz had in mind was, however, a system of entirely disconnected divisional reserve banks. In our debate, I urged him further to explore this scheme; but expressed the view that such a system, in order to be successful, would have to provide for a linking together of these separate reserve banks, so as to insure their operating as a unit. This meant, of course, that his system would, in effect, become a central banking organization. In a later chapter, we shall revert to Mr. Morawetz's contribution.

Arguments such as were used in the controversy with Professor Sprague and Mr. Morawetz, together with an elaboration in detail of a specific central banking plan presented in connection therewith, finally won over my fellow-members of the Merchants' Association. In the end, they gave me their

[1] *A United Reserve Bank of the United States.* Proceedings of the Academy of Political Science in the City of New York, Vol. I, No. 2; *Essays on Banking Reform in the United States*, Proceedings of the Academy of Political Science in the City of New York, Vol. IV, No. 4. See also Volume Two, p. 117.

[2] Morawetz, Victor. *Address on the Banking and Currency Problem and the Central Bank Plan at the Finance Forum of West Side Y. M. C. A.*, New York, 1909.

whole-hearted support; and, on April 27th, 1910, the Association decided to distribute 30,000 copies of my address, "A United Reserve Bank of the United States," together with a like number of copies of my article, "The Discount System in Europe," which, as has been stated, was prepared for the Monetary Commission. There was some delay, however, in securing the copies of the pamphlet from Washington; and it was not until July, 1910, that the copies were finally sent out. The circular letter, which accompanied the pamphlets, read as follows:

THE MERCHANTS' ASSOCIATION OF NEW YORK
54–60 (OLD NUMBER 66–72) LAFAYETTE ST.
NEW YORK CITY

July 27th, 1910

Dear Sir:

For three years a Special Currency Committee of The Merchants' Association of New York has been studying the currency problem of the United States.

The imperative need for improvement in our banking system requires no demonstration. The panic of 1907 furnished an object lesson which brought conviction to every thoughtful business man and banker. The Aldrich-Vreeland Act of 1908 was passed avowedly as a temporary measure and is only a makeshift, which will soon lapse by its own terms.

Our present system is universally admitted to be defective in two respects: First, its bank-note circulation lacks elasticity, promptness in distribution, and celerity of redemption; second, the banking reserve is so scattered as to be unavailable in times of emergency. All the various plans for amendment fall into two classes, which provide either for:

I. Power to be conferred upon the 7,000 national banks of this country to supply themselves, at need, with full currency requirements, basing their issues upon the maintenance of individual reserves, the establishment of redemption or safety funds, and upon bank assets, either generally liable, or specifically pledged, or

II. The creation of a central institution to concentrate into one central reservoir a portion of the lawful money reserves of all the banks, state and national; to devote itself specially to the management of the currency and to the rapid solution of currency problems; to be so devised that all solvent banking institutions shall be able to command immediately, by the ordinary methods of banking procedure, whatever bank-note currency they may deem necessary for the demands of their depositors, and to retire the same without loss when no longer needed.

For a time we shared the opinion of many advocates of a more modern system of note issues that, while a central bank was the logical solution of the problem, conditions peculiar to the United States were unfavorable to its adoption.

The main objections against the establishment of a central bank in the United States appeared to be:

First: Danger of political control,

Second: Danger of control by special interests,

Third: Hurtful competition with existing banks.

Continued deliberation, however, together with the investigation of plans more recently offered, have led us to believe that a currency system involving the use of a central bank may be made feasible for this country.

In the hope that discussion of this important subject may be stimulated, we send you herewith two pamphlets prepared by Mr. Paul M. Warburg, a member of our Committee with wide experience in banking. One of these pamphlets, entitled "A United Reserve Bank of the United States," offers a sound solution for the defects of our present banking system. The other, a monograph prepared for the National Monetary Commission on "The Discount System in Europe," shows the close inter-relation between the discount system and the central bank system in Europe, contrasts European conditions with our own, and explains why a bank that is to perform in this country functions like those exercised by the European central banks must be adapted strictly to our own needs and conditions and must differ greatly from its European prototypes.

It is our opinion that Mr. Warburg's plan would provide no more than a legitimate extension of the banking facilities of the United States. With such an institution in existence as the United Reserve Bank he proposes, a currency famine and money panic would become impossible, the monetary reserve would be effectively utilized, the national Treasury relieved of all responsibility for the money market, and international exchanges and movements of gold easily regulated with immense benefit to all producers, distributors, and consumers alike, in every station of life.

Respectfully,

CURRENCY COMMITTEE OF THE MERCHANTS' ASSOCIATION OF NEW YORK

By Irving T. Bush, Chairman

The articles published by me from 1908 to 1910 (reprinted herein as Part One of Volume Two) constitute a series of persistent efforts to arouse public opinion to a recognition of the fact that banking reform in the United States, in order to be successful, would necessitate the radical change from decentralized to centralized banking.

Reviewing these efforts in their chronological order, one can readily perceive how, step by step, the central bank thought advances, but how new trenches always remain to be taken. With each new attempt, the method of attack had to be changed and, at the same time, the proposals for the adaptation of the central bank thought to American business and political conditions had to be further evolved and improved.

Thus the first articles simply endeavored to point out the defects of the American system. They compared the methods in force in America with the central bank practices characterizing the best European systems and indicated the general direction which reform in the United States would have to take. The main argument brought forward by those opposed to these early proposals was that it would be impossible to develop, along the lines indicated, a system which would be

bomb-proof against abuse either by politics or by business.[1] Accordingly, the next plans proposed were so designed as to meet and silence those objections. This explains the suggestion of reserve banks restricted in their rediscount operations to the acquisition of commercial paper, guaranteed or endorsed by coöperative banking associations to be formed for that purpose. Safety, in other words, was sought by circumscribing the realm of activity of the central institution to such a degree that no outside individual, firm, or bank could have direct access to its resources. As a further safeguard, local boards, in which control was divided between representatives of banking, commerce, and the government, were designed to supervise the activities, both at the branches and at the head office.

After it had been shown by such suggestions that it was possible to devise a system which would be absolutely safe, a new and entirely valid objection had to be met. This was the claim that such an iron-clad system would be too rigid to be practicable and that, while it was safe enough as an emergency institution, it would not, in the daily life of the nation, function readily enough to play the important part necessary for the success of any central banking organization. Under the pressure of this new objection, it became necessary to develop a plan affording the banks an easier, but, at the same time, a politically unassailable, access to the central system. Accordingly, I developed the thought that it might be perfectly safe to permit the member banks to rediscount short paper, having not more than twenty-eight days to run, without the guarantee of the coöperative banking associations. A careful study of the European systems had elicited the important fact that the bulk of their investments consisted

[1] It is well to remember that the period during which these discussions took place was the time of the struggle of the financial Titans—the period of big combinations, with bitter fights for control. All over the country there was a deep feeling of fear and suspicion with regard to Wall Street's power and ambitions.

of such short paper. Thus, when this simple device was added to the powers of the central institution, together with the provisions that it might discount paper with a maturity of between twenty-eight and ninety days when guaranteed by the banking associations, as well as buy in the open market under certain safeguards bankers' acceptances and foreign bills, and invest in government securities, a practical adaptation of the central bank thought to our political and business requirements was presented, which seemed to meet the requirement of combining safety with elasticity.

This was the plan presented under the title "A United Reserve Bank of the United States." Of course, it was not the only plan that had been evolved on these or other lines. The interest in the problem by this time had become very general and many groups and individuals had made important contributions. Among others, Mr. Maurice L. Muhlemann published "A Plan for a Central Bank,"[1] which proceeded on almost the identical lines followed by me, except that he chose for his model the issuing department of the Bank of England, while I was following the principles and methods of such institutions as the Banque de France and the German Reichsbank.

On the whole, it may be said that the interest of business men and economists during this period was keener and more stimulating than that of the bankers. Mr. Frank A. Vanderlip, then a Vice President of the National City Bank of New York, was a notable exception; he sensed at an early date that the central reserve gospel opened a highly promising vista and there are several letters in my files in which he encouraged me to continue in my efforts. Mr. Charles A. Conant was among the first apostles of central banking, while Mr. A. Barton Hepburn at times commended our campaign, but on other occasions criticized our proposals as being too radical. The American Bankers' Association, at that

[1] *Banking Law Journal*, November, 1909, to March, 1910.

time, played a rather "lone hand," and was not so advanced in its views as were the commercial bodies. My contacts were entirely with the latter and the plan outlined in "A United Reserve Bank of the United States" may perhaps be taken as an indication of the direction in which their thoughts were moving; it was on the whole the product of the deliberations of men who were representatives neither of the "banks" nor of "politics." The scheme evolved with them in this period of inception, "when the law was half made" may, therefore, be considered as an impartial model plan; for self-interest on the part of the banks involved, and political party considerations, had not as yet begun the tug of war which later was to pull it first to one side and then to the other. As the plan contained a great deal, both in principles and in details, that subsequently—as will be seen—found its way into the Aldrich Bill and, through the Aldrich Bill, into the Federal Reserve Act, a detailed description of it will be given in Chapter Three.

On November 12th, 1910, shortly after the publication of "A United Reserve Bank of the United States," I read a paper before the Academy of Political Science entitled "Principles That Must Underlie Monetary Reform in the United States."[1] At this conference of the Academy, many members of the Monetary Commission, including Senator Aldrich, were present; and it was primarily to them that the paper was addressed. It laid down the principles to be considered in devising a system of "centralized reserves and decentralized banking," which was to provide "fluidity of credit strongly safeguarded."

This was the last address I wrote before the Aldrich Plan was published. The thoughts we then fought for have become so generally accepted to-day that, to the student of this

[1] *Principles that Must Underlie Monetary Reform in the United States*, Proceedings of the Academy of Political Science in the City of New York, Vol. I, No. 2; *Essays on Banking Reform in the United States*, Proceedings of the Academy of Political Science in the City of New York, Vol. IV, No. 4. See also Volume Two, p. 165.

generation, it may seem strange that so much effort had to be wasted in order to prove a thing so obvious. From this point of view, it may be useful to quote a single contemporaneous article illustrating how novel the suggestions seemed at that time, even to those best informed and most advanced. A leading article which appeared in *The Financial and Commercial Chronicle* has been singled out for that purpose, because the *Chronicle* is generally considered one of our foremost financial journals, and because its discussion of my article was particularly thorough. Incidentally, the reader is likely to be impressed by the fact that, although the editorial was written in November, 1910, it might just as well be applied, so far as principles are concerned, to the Reserve System as it stands to-day. The text of the article follows:

THE FINANCIAL SITUATION

In considering the admirable address delivered on Saturday last by Paul M. Warburg of Kuhn, Loeb and Company, at Columbia University, at the conference on the currency question held under the auspices of the Academy of Political Science, one is led to think how easy it would be, theoretically, to construct a perfect banking and currency system for the United States under Mr. Warburg's guidance, and yet how beset with difficulties must be the task of putting such a system into practical effect. It is evident from the carefully guarded utterances of Senator Aldrich at the aforesaid conference that the Monetary Commission has as yet made very little progress towards formulating its views on the subject. But this is tantamount to saying that there are so many practical obstacles to be overcome in devising a scheme that shall be at once sound and workable that the members of the National Monetary Commission have as yet been unable to solve the problem in a way satisfactory to themselves. If it were possible to begin de novo in the construction of a banking system, and if there were not preconceived notions and ideas to overcome, the task would be by no means baffling

to the ingenuity of the trained mind. But to take the crude system which we now have and to seek to adapt it to modern requirements—which means practically to uproot it in some of its most essential parts—makes the undertaking one of Herculean proportions, from which the cautious investigator shrinks more and more the deeper he gets in his study of the subject.

Mr. Warburg furnishes the outlines of a scheme that seems altogether sound, theoretically, and he works out his ideas in a thoroughly logical fashion. And yet as he develops one feature after another in his plan, leading the mind to marvel at the masterful way in which it has been constructed, the question which suggests itself with ever-increasing force is whether its very merits, as an argumentative proposition, would not be the strongest objection to it from the standpoint of the legislator, by reason of the radical departure from existing methods which it would involve. It is at all events clear that the practical carrying out of the plan would at one stage or another of the process encounter innumerable obstacles and drawbacks, founded on prejudice and long-established usage, which it would be almost impossible to overcome and which would fail to command for the new scheme that general assent necessary to make it a success.

Mr. Warburg lays down the doctrine that "a financial system which scatters and decentralizes reserves, and makes them unavailable and insufficient in case of need, is fundamentally wrong and defective." "In a modern system," he argues, "constructed on credit, cash must be centralized as far as possible into one big reservoir, from which everyone legitimately entitled to it may withdraw it at will and into which it must automatically return whenever it is not actually used." But how is this desideratum to be obtained? He tells us that "the central bank, having cash obligations, must have the strongest *reserve of cash* and quick assets payable within a short time. The general banks, having obligations payable only in cash credit, need have reserves only in *cash credit* and in quick assets convertible at all times into cash

credit." In another part of his address he says that "cash balances with the central reservoir or its branches must be considered and counted by the banks as cash in their own vaults." More than that. "The central organ must have power to request the banks to keep *with it* cash balances *proportionate to the amount of their deposits* owned by banks." In a footnote he tells us that by "banks" is always meant national banks, state banks, and trust companies.

But would the large financial institutions in New York and Chicago and other central reserve cities, a number of which have attained dimensions putting them on an equality with some of the great central banks of Europe, readily, or ever, yield up their present right of holding their cash reserves in their own vaults? Is it not certain that they would oppose, with all their might, the transfer of their own cash to some central organ in exchange for the "cash credits" of such central institution—no matter how powerful the central organ might be, no matter how securely safeguarded, and no matter how readily it might yield up its cash on demand? As we interpret Mr. Warburg's plan, the central reservoir is not to be an *additional* reservoir, but practically the sole reservoir. It seems correct to say that cash should be centralized into one big reservoir and that a financial system which "scatters and decentralizes reserves" is wrong and defective. But recent experience and recent education is to the effect that it is not wise to burden the central institution too much or to rely upon it exclusively. Late legislation in this and other States compelling the trust companies to hold extensive cash reserves in their own vaults is founded on that idea. In like manner the English joint-stock banks, after having been for years criticized for relying entirely upon the Bank of England, have within the last twelve or eighteen months in a number of cases been accumulating cash of their own. Mr. Warburg thinks it is becoming recognized "that central banks are not oligarchic but democratic institutions, that central banks by creating safe conditions render the small bank independent of the domination of the large insti-

tution, and that in Europe the central banks are the backbone of the independent banks in their fight against the ever-growing branch banking system." We fear Mr. Warburg is a little too sanguine in this respect, and that it will be no easy matter to get the average small bank to assent to the proposition, while the larger banks, which are now a power in themselves, will be sure to antagonize it. No objection will be raised to his statement that "a system of *centralized reserves* and *decentralized banking power* is clearly the system that this country requires," but the further conclusion that the country "will gladly accept it when once it has this clearly presented to it in a definite form," may be doubted, for it does not allow for the perversities of human nature or the influence of prejudice and the inclination on the part of the public to regard with suspicion the growth and centralization of power, especially where it takes the corporate form. No development of modern times is more conspicuous than the ever-present antipathy to the latter.

Mr. Warburg says that the United States Treasury should cease to deal directly with the banks. "The central reservoir should be the recipient of the government's surplus funds and should attend to the government's disbursements. The influence in business of the Treasury, a purely political body, must cease." No truer words than these were ever spoken. How to apply them, however, so as to find acceptance for them is another matter. Mr. Warburg undertakes to meet the objections that have been raised against the creation of a central institution by saying that "the management of the central reservoir must be absolutely free from the dangers of control by politics and by private interests, singly or combined." He goes further and outlines a plan by which the dangers of such control would be obviated. Under this arrangement the majority of the board of directors of the central institution would be appointed by groups of banks all over the country, leaving the government directors in a minority. But would Congress ever consent to the Treasury's parting with its cash holdings to the central reservoir,

and the transfer to it even of its $150,000,000 gold reserve, as is contemplated in a certain contingency which Mr. Warburg discusses—would it consent to the turning over of its funds in this way to an institution not under the absolute control of the government? And if the government had such control, how could politics be kept out of it?

We agree entirely with Mr. Warburg in what he says concerning mercantile paper, and also in the preference he expresses for it as an investment for bank funds. There is something very telling about his characterization of "the folly of a system which makes the commercial paper purchased by a bank immovable assets, locking up the capital of the purchaser, and which forces the banks to consider as their only quick assets cash in their vaults, which they must not use, and call loans on the Stock Exchange which during a panic they cannot turn into cash." "Fluidity of credit," he says, "must be our aim. A sound financial system must mobilize its commercial paper and make it a quick asset instead of a lock-up. Mobilized commercial paper must finally become the most important basis of our financial structure, instead of bonds and loans on stock exchange collateral."

He would have the central reservoir deal only with banks, bankers, and trust companies, and he would have it purchase commercial paper from banks and trust companies only. He admits, however, that "the difficulty here is that we have as yet no standard discount paper such as exists in England, France, and Germany, and that, therefore, in order to avoid abuse, some system must be invented which will act as an effective control, and which will supply an additional and safe guarantee." Thus we are up against another snag, though in a previous paper Mr. Warburg made suggestions intended to show how paper of this class could be provided in accordance with a scheme "which, while strict enough to prevent any abuse, could still be made broad enough to allow of practical and effective operation."

The difficulties here outlined are not peculiar to Mr. Warburg's carefully thought-out plan. They are inherent in any

> plan which attempts a reform of our banking and currency system in a thorough-going way. We refer to them here at length because they serve to indicate why progress thus far in the work has been slow, and why every one in authority seems reluctant to proceed in any but the most cautious way. The principles that should apply are well understood, but how to secure acceptance for them and put them into practical operation is the problem which taxes ingenuity.[1]

The foregoing article, which has been given practically in its entirety, is well worth noting, for it shows very clearly the ground which had to be covered before the conservative element could be brought to favor any plan for adequate banking reform.

[1] *The Financial and Commercial Chronicle*, New York, Nov. 19, 1910 (Vol. LXXXXI, p. 1350).

CHAPTER III

THE UNITED RESERVE BANK PLAN
(1910)

THE plan for a United Reserve Bank of the United States was not presented in the form of a drafted bill, but was offered in descriptive form. Only the powers to be exercised by the proposed central institution were formulated in full detail in terms suitable for a prospective law.

In order to enable the reader to compare the draft of the United Reserve Bank plan with the legislative proposals subsequently evolved, first by the Republican party leaders and then by the Democratic party leaders, a full description of the plan is presented in this chapter. The technical clauses, some of which later found their way into the Aldrich Bill and through it into the Federal Reserve Act, are reprinted in full in their original language.[1]

The plan provided for the organization of a United Reserve Bank, with a head office in Washington and some twenty branches, with a share capital of $100,000,000, fully paid, the stock to be divided among the banks of the country. The eventuality was envisaged of selling the stock at a given time to the public. Dividends were to be limited to, "let us say, 4 per cent"; any profits in excess were to go to the government of the United States. (The possibility was discussed of having the United States guarantee this minimum return.) Following the Fowler Plan in that detail, it was proposed to

[1] A juxtaposition of the text of the Aldrich Bill and that of the Federal Reserve Act will be found in Chapter Eight. See also Chapter Nine, *An Analytical Comparison of the Aldrich Bill and the Federal Reserve Act*, and Chapter Ten, *The Legatee of the Aldrich Bill.* For the full text of the United Reserve Bank Plan, see Volume Two, page 117.

divide the country into twenty zones. A local banking association was to be formed in each zone for the purpose of guaranteeing paper offered by member banks—thus making it eligible for rediscount with the United Reserve Bank. The latter was to open a branch in each zone, the branch to be administered by a board of directors to be appointed by the local banking association. Provision was made for dividing the zones into sub-divisions. Member banks were to have the privilege of subscribing their pro rata of the stock; they were to have the privilege of withdrawing from membership.

The provision in the plan prescribing the constitution of the board of directors of the bank was as follows:

> In order that the Board of Directors of the United Reserve Bank in Washington may be thoroughly representative of the various interests and districts of the country, that it may be non-political, non-partisan, and non-sectional, a certain number of the directors, say three-fifths, should be appointed by the banking associations; a further number, perhaps one-fifth, should be elected by the stockholders; while the Secretary of the Treasury, the Comptroller of the Currency, the Treasurer of the United States, and others to be nominated by them, should fill out the remainder of the Board. It might be advisable to provide that no director, excepting the *ex officio* members, should serve more than a certain number of years in succession.
>
> In order that commercial interests be adequately represented, provision might be made that the members appointed by the stockholders should not be bank or trust company presidents, and that these members should be elected preferably from the class of merchants and manufacturers. One would then have a mixed board, of whom three-fifths would be bankers, appointed by the banking associations, while one-fifth would be chosen from the commercial classes by vote of the stockholders, and one-fifth would be *ex officio* government members and the additional members appointed by them.
>
> This board should have the right to elect one or two gov-

ernors of the United Reserve Bank, who would be salaried officers appointed, like other bank presidents, for an indefinite time, irrespective of political considerations, and remaining in office as long as they render satisfactory service.

The main powers of the United Reserve Bank were outlined as follows:

1. To accept deposits from the government of the United States and from members of the banking associations only. No interest should be paid on such deposits, but they might be counted as cash (and as part of the required reserve—*Author*) by the banks and trust companies making them.

2. To buy from members of the banking associations, at a discount rate to be published from time to time, commercial paper having not more than twenty-eight days to run, and issued at least thirty days before the date of rediscounting. The aggregate amount which it might buy from each member should be restricted to a certain proportion of the unimpaired capital and surplus of such member, and the aggregate amount issued by one issuer of commercial paper to a member of the banking association and rediscounted with the United Reserve Bank, should also be limited to a certain proportion of such unimpaired capital and surplus.

3. To buy from member banks, at a discount rate to be published from time to time, commercial paper having more than twenty-eight days to run, but in any case less than ninety days. The aggregate amount to be rediscounted by the United Reserve Bank from each member and the aggregate amount admissible from individual makers of notes should be restricted as under (2). Such paper, however, could be discounted by the United Reserve Bank only with the endorsement or guarantee of the banking association to which the member belonged.[1]

[1] In consideration of such guarantee or endorsement, the banking association would receive from the member handing in paper for rediscount a certain remuneration, let us say ¼ or ½ of 1 per cent in the interest rate. The banking associations would, of course, like the clearing houses, when clearing-house certificates are issued, have the right to reject any paper which they did not deem safe or proper to guarantee or endorse.

4. To buy, at a discount rate to be published from time to time, paper having not more than ninety days to run drawn by a commercial firm on, and accepted by a bank, trust company, or banker, and endorsed by a bank, trust company, or banker. One of these signatures should be that of a member of the banking association. Limits as to amounts of acceptances admissible from time to time for discount with the United Reserve Bank should be fixed by the central board.[1]

5. To buy bills on England, France, Germany (and such other countries as may be decided upon), such bills to have a maximum maturity of ninety days, to bear one commercial signature, to be drawn on, and accepted by a well-known foreign banking house, and endorsed by a member of a banking association or a banker in good standing. The United Reserve Bank should have power to resell all bills that it might buy and to do all things necessary for their collection.

6. To deal in bullion, and to contract for advances of bullion, giving security therefor, and paying interest on such advances.

7. To buy and sell bonds and Treasury notes of the United States.

8. To issue circulating notes, payable on demand in gold; such notes to be secured by bills, bought by the bank under provisions (2) to (5), and by gold to the amount of at least 33⅓ per cent of the aggregate amount of outstanding notes.

9. To establish branches in places where there are head offices of banking associations. Such branches under the direction of the central board of the United Reserve Bank might do the same business as the head office. Each branch would have a local board, chosen by the board of managers of the local banking association, to which board might be added some members of the commercial classes appointed by the head office in Washington. This local board would supervise the business of the branch bank, and elect its salaried

[1] It might be advisable to provide that in case of emergency the central board, with the approval of the Secretary of the Treasury and the President of the United States, might increase the limits fixed under 2, 3, and 4.

president, subject to the approval of the central board in Washington.

10. To request banks or trust companies desirous of making use of the services of the United Reserve Bank, to keep with its branches a cash balance commensurate with the amount of business done by them. The United Reserve Bank should have the right to transfer sums of money from the account of one member to that of another upon request.

11. To join the clearing-house association of the various cities where the bank and its branches are located.

The powers of the central office were formulated as follows:

> . . . The central office would merely indicate the policy; the branches, which practically are under the supervision of the local banking associations, would undertake certain well-defined, safe transactions, into which no element of politics could enter, any more than it enters into our clearing house.

The power to fix the discount rates was vested in the central office. It was specifically stated that these discount rates "need not necessarily be the same" in all branches.

The following quotations from "A United Reserve Bank of the United States" further explain the proposal.

> The cash reserves now scattered and useless will be concentrated into an effective central reserve. The general banks will hold a sufficient amount of till money for their requirements, but as a reserve they must hold a cash balance with the United Reserve Bank, commensurate as at present with the aggregate amount of their deposits. . . .
>
> The bank will act like a huge clearing house for the settlement of balances between various sections. Millions are now constantly in transit, moving to and fro, crossing and recrossing one another in opposite directions. Hundreds of millions are kept in scattered balances, which can be centralized under the new system. . . .

The new system makes commercial paper a quick asset which can be converted into a cash credit or into actual cash. Our present scandalous system of attempting to regulate the money market of the entire country by first pouring money into the stock market and then withdrawing it, creating inflation and exorbitant security prices, followed in due course by stringency and unnecessary price depression, will give place to more orderly movements, as our discount markets develop. . . .

In order to secure an elastic currency and a safe basis for a United Reserve Bank, we must reduce our outstanding currency somewhere, so as to substitute the new elastic note issue—an issue that will contract, so that it can expand with safety. One way would be an inverse conversion; that is, a gradual withdrawal of the existing note-issuing power with a simultaneous conversion of our government bonds into obligations bearing a somewhat higher rate of interest, thereby safeguarding the banks against a loss in the price of their bonds. . . .

. . . As far as reserves are concerned, they will be united and act as one. The surplus of one section will be available for other sections and the interests of all together will bring about the general policy of the United Reserve Bank.

The effectiveness of this plan would not be interfered with by a provision that the discount rates of all the branches need not necessarily be the same. Thus it might be possible to meet undue expansion in one section of the country by increasing the rate of that branch without increasing the rate for other sections. . . .

It should be clearly understood that the United Reserve Bank, by creating safe conditions, would make the small banks independent, where they now have to rely, and are dependent for help, on the good-will of their big sisters, or the often doubtful ability to help of the Secretary of the Treasury. A central reserve bank properly organized is not an oligarchic but a democratic institution; it would mean safety for all, hardship for none. . . .

In the years covering the period between the publication of this plan in 1910 and the enactment of the Federal Reserve Act at the end of 1913, some of the thoughts expressed in the United Reserve Bank Plan were further matured and modified. For example, when I appeared before the House Committee on January 7th, 1913,[1] I expressed the view that in order to bring about a well balanced control of the System it would be advisable to empower the government to appoint a little more than one-half of the members of the board of the central office, in addition to the *ex officio* members, and to permit the other members to be appointed by the banks. With reference to the boards of the branch banks, i.e., the Federal reserve banks, the suggestion was made that the directors appointed by the member banks should be slightly in the majority.

It may be noted in passing that the theory thus outlined in my testimony was followed in the first drafts of the Glass Bill, until President Wilson—siding with the Owen-Bryan faction—enforced his will by making the central board consist entirely of members appointed by the President. The directorates of the reserve banks, on the other hand, are constituted to-day along the lines above recommended. This matter is more fully dealt with in subsequent chapters.

[1] See Appendix Three.

CHAPTER IV

THE ALDRICH PLAN
(1910–1912)

SHORTLY after the National Monetary Commission had completed its investigations in Europe and had returned to this country, I was invited to appear before it at a hearing held in the Metropolitan Club of New York. At that hearing, there was no discussion of the broad problem of banking reform; but a list of the authorities consulted by the members of the Commission in Europe (from August 12th to October 13th, 1908) was shown to me and my opinion was asked concerning them. When the Commission adjourned, Senator Aldrich detained me for a moment.

"Mr. Warburg," he said quietly, "I like your ideas. I have only one fault to find with them."

This intimation that the Senator had been won over to the central reserve doctrine came like a thunderbolt from a clear sky; but I asked, with as great composure as I could command, what that fault was.

He answered, "You are too timid about it."

This was an even more intense surprise to me than his first statement, and I replied that, so far, it had appeared to me that I was almost the only person in the banking reform movement who had shown any courage about it.

He said, "Yes, but you say we cannot have a central bank, and I say we can."

It is easy to imagine, but hard to describe, the mixed feelings of joy and bewilderment into which this remark threw me, for suddenly I found our rôles reversed. Whereas before I had doubted whether the Senator could ever be persuaded to consider any central reserve plan, I now found it my part to

dissuade him from going too far in that direction. Accordingly, I explained to the Senator why any attempt to establish a full-fledged central bank, in the European sense, appeared to me to be inadvisable. The main reasons given were, first, that the operations of the European central banks were predicated upon a large bill market, in which modern bills of exchange could readily be bought and sold, which was lacking with us; and, second, that a central bank such as existed in Europe, having wide powers to deal with individuals, was not politically possible in the United States on account of the dangers of abuse and the deep-seated prejudices and suspicion which it would encounter. And, finally, it was to be feared that such a central bank, if established, would not live long, because it was likely to become almost at once a target for bitter political attacks.

Although the Senator listened to these arguments, he did not give any indication that he was hospitable to them. But, needless to say, when I left the Metropolitan Club I was elated, because what only a few hours before had appeared to be an insurmountable obstacle in the way of progress was now crumbling away and, for the first time, I felt confident that genuine banking reform was within grasp of the United States.

My next contact with the Senator came late in 1909, when in view of the imminence of a new issue of government bonds, I wrote to him, expressing the hope that he would oppose the issue of any more bonds with the circulating privilege. I also took this opportunity of bringing to his attention the fact that the *Banking Law Journal* had sent out letters of inquiry to state and national banks throughout the country, asking them, "Do you favor a central bank, if not controlled by Wall Street or any monopolistic interest?" and that, of the total of 5,613 answers, about 60 per cent were in the affirmative, 33 per cent in the negative, and 7 per cent undecided. I added, "When one takes into consideration that the main reason given by those who answered in the negative was that

they did not believe it would be possible to create a central bank which would be free from Wall Street control, one cannot help feeling very confident, for it will not be difficult to disprove that argument."

While my correspondence with Senator Aldrich remained rather halting and one-sided, the Senator hardly ever answering my letters, quite an extensive correspondence developed between Professor A. Piatt Andrew, Special Assistant to the National Monetary Commission, and myself, in the course of which I furnished him with data for certain books which the Commission intended to publish, together with the names of competent translators, and other information of a similar nature. Of course, I sent to both Senator Aldrich and Professor Andrew copies of my articles and, at Professor Andrew's request, I also mailed copies to certain members of Congress.

In November, 1910, I was invited to join a small group of men who, at Senator Aldrich's request, were to take part in a several days' conference with him, to discuss the form that the new banking bill should take. During this conference I had my first opportunity of studying the Senator carefully, and I was deeply impressed by the earnest devotion with which he approached the subject and the untiring patience with which he applied himself to it. I believe that there was not a page of the thirty-five volumes collected and published by the National Monetary Commission which he had not read. The questions he asked indicated at once that he had penetrated quite deeply, not only into the theory, but also into the technique, of the banking problems involved. He differed from Senators Owen and Glass, with both of whom it later became my privilege to collaborate, in that he had essentially a business mind. I was also impressed by the fact that, although he was a very shrewd politician, he showed a surprising disregard for party politics in dealing with our particular problem. We were, after all, discussing a proposal

which involved a revolutionary break with old Republican banking traditions; but not once in all the deliberations was that phase of it mentioned. On the contrary, he always stressed the imperative necessity of dealing with the question on a non-partisan basis. While I had approached Senator Aldrich with a good deal of prejudice and suspicion, I soon became convinced that the only object he had in mind was to establish in the United States, as a final monument to his long service in Congress, the best banking system that political and economic circumstances would permit. In talking to him, I often wondered what was the secret of his great political power in Congress and, to judge from my own experience with him, I should say that it must have been his indefatigable, painstaking willingness to ascertain the facts down to their very last details. With the same thoroughness and patience, he seemed to analyze and approach the individuals destined to play a part in the matter at issue.

When I joined the conference, I was quite at sea as to what its outcome would be and frankly skeptical as to its prospects of success. During the first days' sessions, Senator Aldrich was much inclined to discuss the possibilities of a full-fledged central bank on the European order—a model he seemed loath to abandon. But when the conference closed, after a week of earnest deliberation, the rough draft of what later became the Aldrich Bill had been agreed upon, and a plan had been outlined which provided for a "National Reserve Association," meaning a central reserve organization with an elastic note issue based on gold and commercial paper. This was not a central bank in the European sense. It was strictly a bankers' bank with branches under the control of separate directorates having supervision over the rediscount operations with member banks.

In its main principles and in many important details the Aldrich Bill was closely akin to the plan proposed in the

"United Reserve Bank of the United States," [1] but there were quite a number of differences, with some of which I was in complete disagreement. For example, in regard to the question of control, I thought that somewhat larger concessions should have been made to government influence and representation. Neither was I in full accord with the provisions regarding taxation, note issue, the uniform discount rate, the plan proposed for dealing with the 2 per cent government bonds, or the conditions attaching to the membership of state banks and trust companies. Moreover, the Senator had not yet agreed to a provision, which seemed to me of fundamental importance, that of giving the notes of the National Reserve Association the status of lawful reserve money when in the tills of member banks. The bill frankly followed the Republican doctrine of "keeping the government out of business;" but, as a starter, it was encouraging beyond all expectation. Indeed, the highest hopes seemed warranted that a most satisfactory piece of legislation could eventually be developed from it.

The results of the conference were entirely confidential. Even the fact that there had been a meeting was not permitted to become public.[2]

The period during which non-political thought held the leadership in the banking reform movement may be considered as having ended with this conference. Senator Aldrich had now adopted the general principles of the project; he had evolved the Republican version of a central-bank plan and had made himself its standard bearer. Where before, it had been an educational campaign carried on by individuals

[1] *See* Vol. II, p. 117. *See also* Chapters Eight and Nine of this volume for comparisons of the Aldrich Bill and the Federal Reserve Act.

[2] Though eighteen years have since gone by, I do not feel free to give a description of this most interesting conference concerning which Senator Aldrich pledged all participants to secrecy. I understand, however, a history of Senator Aldrich's life by Professor Nathaniel Wright Stephenson is shortly to be published, and that this book will contain an authorized account of this episode.

and groups, the movement was now to assume a national character. From then on until the final passage of the Federal Reserve Act, the generalship was in the hands of political leaders, while the rôle of banking reformers was to aid the movement by educational campaigns and, at the same time, to do their utmost to prevent fundamental parts of the non-political plan from being disfigured by concessions born of political expediency.

The next step was for the Senator to submit the synopsis of the draft of the Aldrich Bill to his fellow-members of the Monetary Commission in order to secure their approval and backing.

Meanwhile, a number of public bodies studying the question had extended invitations to me to address them or to assist in carrying on their own investigations. Among these were the Board of Trade of Philadelphia, the Produce Exchange of New York, the National Association of Credit Men, and the Chamber of Commerce of New York. Mr. A. Barton Hepburn, the President of the New York Chamber of Commerce, appointed me a member of its Banking and Currency Committee in December, 1910.

The National Board of Trade had taken a very lively interest in banking and currency reform. Mr. Frank D. Lalanne and Mr. William R. Tucker, who were members of the Philadelphia Board of Trade, were particularly active in this movement, and we frequently exchanged views. The National Board of Trade now called a conference at Washington and set aside January 18th, 1911, as "Monetary Day." Delegations were to be sent from chambers of commerce and boards of trade in all parts of the country. Resolutions to be presented at the conference were under preparation by both the Chamber of Commerce and the Merchants' Association of New York. Each of the two bodies having appointed me a delegate to the conference, and the Produce Exchange having been in communication with me concerning the resolution it wished to

present, I was able to prevail upon all three associations to have a joint meeting and to prepare a joint resolution.

The work of preparing this joint resolution created a rather peculiar situation. I knew, of course, what proposals the chairman of the Monetary Commission was about to recommend but, having been pledged to secrecy, I could not mention them to my colleagues. It was most important, however, to have our resolution framed in general accordance with the findings of the Monetary Commission. The task would have been one of extreme embarrassment had it not been for the fact that the main principles underlying the Aldrich Bill were so much akin to the ones I had preached so long and so often.

There had been delay after delay in the publication of the Commission's Plan by Senator Aldrich. The uncertainties of the Congressional situation, no doubt, baffled him greatly and dictated a policy of extreme caution; his tendency to procrastinate was aggravated, moreover, by his physical condition which, at that time, began to alarm his collaborators. It had repeatedly been urged that the plan be made public before the conference of the National Board of Trade, which seemed to offer a unique opportunity for securing an important endorsement at the very moment of the launching of the bill. The stage had been set, but when I left New York, on the day before the conference, the Senator had not yet divulged his plan. That very afternoon, however, as the New York delegates to the Washington conference were passing through Philadelphia, the evening papers brought before the public for the first time an outline of the Aldrich Plan. There was, of course, a general feeling of delight among the delegates when they discovered how closely their resolution accorded with what the Monetary Commission now recommended.

A very comprehensive account of the Monetary Conference of the National Board of Trade was given by the delegates of the Chamber of Commerce of the State of New York upon

their return from Washington. Their report, dated January 30th, 1911, is well worth reading. It is reprinted in full herein as Appendix Four. The following quotation from the *New York Journal of Commerce* gives a brief résumé of what took place at Washington:

> *Washington, January 19th, 1911:*—The National Board of Trade to-day substantially endorsed the principles of the Aldrich Plan of monetary reform by adopting the resolutions offered by the Chamber of Commerce of the State of New York, the Merchants' Association of New York, and the New York Produce Exchange, recommending a "central banking organization." Tentative plans were drawn for a monetary league of business men soon to be organized by the National Board. . . .
>
> The preamble and resolutions as adopted are as follows:
>
> *Whereas*, A modern financial system, which must rest upon credit supported by adequate gold reserves, can be safe and efficient only if so organized as to enable the concentration of idle cash in one reservoir, and to render such cash always speedily available for all legitimate needs, thus assuring confidence; and
>
> *Whereas*, Careful investigation and the experience of all other great nations have demonstrated that a central bank system is the most efficient instrumentality for this purpose, providing the means for such concentration of cash and assuring the transformation into cash, whenever needed, of deposits, commercial paper, and other proper forms of credit, conserving the gold resources of the nation and maintaining the same at a safe proportion to its cash obligations; and
>
> *Whereas*, The banking system in use in the United States has proved disastrously defective, because
>
> It scatters reserves among more than 20,000 banks, each striving in time of stress to strengthen itself at the expense of the other;
>
> It prevents the utilization of reserves and the mobilization of the resources of banks which are invested in commercial paper;

It substitutes stock-market loans for discounts of commercial paper, making the former the regulator of the daily supply and demand for credit;

It provides for note issues absolutely irresponsive to business requirements, bringing about alternation of inflation and stringency;

All of which defects tend to destroy confidence and generate crises; and

Whereas, This convention is convinced that it is practicable to create a central banking organization for the United States, free from political or sectional control by means of which these defects can be remedied; an instrument, not of monopoly, but for strengthening and preserving the independence of the individual banks; an institution designed primarily for public service and not for profit; not to compete with existing banks, but to assist all of them to serve the business communities more efficiently; now, therefore, be it

Resolved, That this convention unequivocally declares itself in favor of the creation for the United States of a central banking organization, based upon the following general principles:

1. That such central organization be a corporation endowed with a large stock capital and not merely an association of banks.

2. That its stock capital be owned by incorporated banking institutions, including trust companies, whether under national or State charter, willing to assume equal duties as a basis for equal privileges.

3. That its administration be divided between the government, the member banks, and the commercial classes, in a manner which will safeguard against individual, sectional, or political combination.

4. That its business be limited to transactions with the government and with the incorporated banking institutions which become stockholders, i. e. member banks, except as provided in paragraph 9, clause B.

5. That dividends on its stock be limited to a fixed moderate return, and profits in excess of such dividends, after providing

for a reasonable surplus and emergency fund, be turned over to the government.

6. That its business be conducted through branches to be established in the banking districts into which the country shall be divided, the member banks of the several districts constituting joint associations and sharing in the administration of the branches.

7. That it shall, free of charge, receive and disburse all moneys of the United States Government in places where it shall have offices.

8. That it shall not allow interest on deposits.

9. That it shall have power:

(a) To issue circulating notes payable in gold, to be secured by gold and negotiable paper, and, if necessary, eventually to retire the present bond-secured bank notes, by a limited amount of government bonds;

(b) For the regulation of its gold reserve to buy and sell bullion, and to contract for loans of gold, and under proper restriction to deal and invest in foreign bills of exchange;

(c) To require the member banks to keep with it a portion of the reserve prescribed by law;

(d) To rediscount, only for member banks, commercial paper under regulations prescribing the limit of amount for each member bank, the maximum time to run, and determining the degree of guarantee to be provided by the joint associations of member banks of each district;

(e) Under careful and proper restrictions to discount approved American acceptances;

(f) To transfer funds standing to the credit of a member bank, to the credit of any member bank at any of its branches;

(g) To buy and sell the bonds and Treasury notes of the United States.

10. That the central organization is ultimately to become the sole note-issuing power.

Resolved, Furthermore, that copies of this resolution be sent to the President of the United States, to the members of the National Monetary Commission and to each Senator and Representative in Congress.

It is interesting to see how much of the resolution passed by the National Board of Trade conference might have been used three years later in support of the subsequent Federal Reserve legislation; or, putting it differently, how many of the recommendations here made were ultimately adopted by the writers of the Federal Reserve Act.

The task of winning the leading bankers over to the Commission's Plan fell primarily on Senator Aldrich. With infinite patience he saw them, one by one; and it was due largely to the unique position he held with them, to his thorough knowledge of the problem, and to the care with which his bill had been prepared that the heads of the largest financial institutions, men who in the nature of things are usually temperamentally and traditionally averse to radical changes, were, one after another, won over to the support of his plan.[1]

Presently a conference took place at Atlantic City, lasting from February 10th to February 12th, 1911, at which about twenty leading bankers from all parts of the country were invited to discuss critically the details of the Aldrich Bill. Senator Aldrich was not present at this meeting on account of ill health which had rendered it imperative for him to seek a few months of complete rest in the South. The Atlantic City conference resulted in a full and frank discussion of a project which many of those present approached in a spirit of openly expressed antagonism. At the end of the conference, however, the champions of the bill felt greatly encouraged, because, barring a few slight modifications, it had been fully endorsed by the conference. Later in the year, Senator Aldrich went on a speaking tour which took him over a large part of the

[1] In this campaign Mr. Frank A. Vanderlip, then a Vice President of the National City Bank of New York and the late Mr. Henry P. Davison, then a Vice President of the First National Bank of New York, were of the greatest aid to Senator Aldrich. Mr. Davison had accompanied the National Monetary Commission on its trip to Europe, and he seemed to enjoy Senator Aldrich's confidence and friendship in a very high degree.

country, and which greatly stimulated the general discussion and understanding of the bill. He spoke at Chicago on November 11th, 1911, at Kansas City on November 14th and 15th, 1911, and at New Orleans on November 21st, 1911. An abstract of the New Orleans address is presented herein as Appendix Five. It is interesting to note the similarity of the arguments used by Senator Aldrich and those brought forward later on by the proponents of the Federal Reserve Act. As an illustration we quote the following passage from Senator Aldrich's speech. Explaining his plan Senator Aldrich said:

> . . . We propose to reconstruct the banking system of the country so that individual banks will be able at all times to protect not only their customers but the community they represent. . . . We propose to concentrate the cash reserves of the country so that they can be used to protect not only the reserves of individual banks and communities and districts, but those of the whole country, in the same way that the great institutions of Europe protect and conserve the credit of their respective countries. *We propose to do that, not by an organization like a central bank, but by an organization that affords a concentration and mobilization of cash reserves, and at the same time secures a decentralization of control.*[1]

It is amusing to observe that in the debate upon the Aldrich Plan the Democratic attacks were based on arguments very similar to those the Republicans used when some years later they were called upon to discuss the Federal Reserve Bill. One almost believes oneself to be reading Senator Glass's *Adventure in Constructive Finance* when one finds in Senator Aldrich's Chicago speech a passage such as the following:

> We have one class who are perfectly certain from their understanding of the plan, that its adoption would result in enormous inflation and dangerous expansion of credits. We have another class who are quite as certain that the provisions of the plan are not sufficiently expansive.

[1] The italics are mine—*Author.*

On March 3rd, 1911, the New York Chamber of Commerce endorsed the principles of the Aldrich Plan.

An editorial published in *The New York Times* of March 4th, 1911 (reprinted herein as Appendix Six) throws a humorous light on the discussion preceding the vote in that organization.

The resolution passed at Washington by the National Board of Trade in favor of the organization of a league of business men was not the first attempt that had been made to organize a representative body of citizens in favor of monetary reform. Some years earlier, the Merchants' Association of New York had embarked upon a similar undertaking. The first attempt failed because, at the time, the necessity of a far-reaching reform and the lines such a reform should follow, had not become sufficiently crystallized in the public mind.

When Senator Aldrich's Plan had taken a tangible and highly promising form, it seemed that the psychological moment had come to try once more to form such a league. It was certain beyond doubt that, unless public opinion all over the United States could be educated and mobilized, any sound banking-reform plan was doomed to fail. The few friends to whom these thoughts were explained were frankly skeptical. They warmly approved of the idea of such a campaign, but doubted the possibility of raising the very substantial sums necessary to swing it successfully. Three years of hard work and persistent progress in the field of banking reform had demonstrated, however, that where there's a will, there's a way; and now, having advanced so unexpectedly near the coveted goal, it seemed imperative to attempt the venture, no matter how impossible it might appear. For obvious reasons, it would have been fatal to launch such an enterprise from New York; in order to succeed, it would have to originate in the West. It was in accordance with these thoughts that the Washington resolution for the National Board of Trade conference had been formu-

lated. As a result of that resolution, Mr. C. Stuart Patterson, of Philadelphia, was charged with the appointment of a committee of seven to consummate the organization of a business men's monetary reform league. Mr. Patterson was particularly well qualified for the task. His interest in banking reform was well known and his name carried great weight because he had served as chairman of the Committee on Metallic Currency of the Indianapolis Monetary Commission of 1898.

The Committee as finally constituted consisted of the following men:

C. Stuart Patterson	Philadelphia
Harry A. Wheeler	Chicago
Frederick W. Upham	Chicago
Irving T. Bush	New York
James J. Storrow	Boston
George D. Markham	St. Louis
Paul M. Warburg, *Chairman*	New York

Five members of this Committee met at Chicago on April 26th, 1911, and began to confer with some of the representative men of the city. Owing largely to the personal efforts of Mr. Harry A. Wheeler, a group of leading citizens of Chicago finally agreed to undertake the task of organizing the league and placing its affairs on a secure foundation.[1] By June 8th, 1911, the National Citizens' League for the Promotion of a Sound Banking System was completely organized. Its first set of officers was as follows:

John V. Farwell	President
John Barton Payne	Vice President
J. Laurence Laughlin	Chairman of the Executive Committee
A. C. Bartlett	Treasurer
M. S. Wildman	Secretary of Organization

[1] The National Citizens' League published a pamphlet entitled *The Origin of the League* which, in part, is reprinted herein as Appendix Seven.

These officers constituted a strong group of independent and energetic men who assumed full responsibility for the League's activities. They immediately embarked upon a very ambitious program. It provided for the organization of local committees all over the country,[1] for the dissemination of literature, and for the sending of speakers throughout the United States in order to awaken interest in, and to promote a general understanding of, the principles upon which a sound monetary reform would have to be based.

The Committee was fortunate in being able to persuade Professor J. Laurence Laughlin, of the University of Chicago, to become the active head of the League. For two years he devoted his entire time and energies to the successful management of this campaign. The services of other leading economists were also secured. The League was financed entirely by voluntary contributions, some large and many very small. Among the most liberal contributors were the banks, which had swung into line and by this time had become warm supporters of the campaign. During the life of the League, a fund of approximately half a million dollars was raised for its use.

Among the leaders of the League there were many prominent Democrats. This was of great importance, as the complex political situation in Washington, where President Taft had lost control of Congress, made it clear that monetary reform could succeed only on a distinctly non-partisan platform. It was, therefore, only a dictate of wisdom for the League, if it wished to win country-wide support, to limit itself to principles and to abstain entirely from backing a specific bill. In keeping with this, the League consistently refused

[1] In New York, a sub-committee was established with Mr. John Claflin as Chairman, and Mr. William Sloan as Treasurer. The Executive Committee of this organization, under the able chairmanship of Mr. Irving T. Bush, vied with the Chicago Committee in furthering the aims of the campaign.

to commit itself to the Aldrich Plan. The first press statement of the League [1] emphasized this point by saying:

> The object of the National Citizens' League to be established is to carry on an active campaign for monetary reform *on the general principles of the Aldrich Plan without endorsing every detail of the National Reserve Association.*

There were times when Senator Aldrich was not at all satisfied with this policy, but the League stuck to it consistently to the end.

A reproduction of a post card which was sent out by the League in its campaign to win popular support may be found on pp. 72 and 73.

The League published a periodical, *Banking Reform*, which at first appeared weekly, and later twice a month. It had a circulation of about 20,000 copies which, in the main, went to newspaper editors all over the country, who soon began to look upon it as their chief source of information with regard to the problem of banking reform. In addition, the League published pamphlets written for it by men whose names commanded confidence in the business world.[2]

Soon after the organization had been perfected, it was decided that a handbook should be published to serve as a catechism for those who wished to study the problem. For the preparation of this volume, which was to adhere closely to the principles endorsed by the League, the services of Dr. H. Parker Willis were secured. In becoming so intimately conversant with the principles for which the League stood, as well as with the technical features under discussion, it is to be presumed that he gained a familiarity with the subject which, later on, proved valuable in the work he was invited to undertake as the expert for the Glass Committee.

[1] *Chicago Herald*, April 27th, 1911.

[2] Among the writers of pamphlets for the League were the following: J. Laurence Laughlin, John V. Farwell, Franklin MacVeagh, John Perrin, George E. Roberts, A. C. Bartlett.

The National Citizens' League

For the Promotion of a Sound Banking System

A Non-Partisan Association of Men of All Occupations

The panics of 1893 and 1907 showed every thoughtful business man that something was wrong with our monetary system. We now have sound banks, but an unsound system, in which banks are isolated and do not co-operate in time of danger.

The League has no bill of its own; it is open to suggestions from any source. But it presents the following objects to be attained which it hopes to have incorporated into law:

1. Co-operation, not dominant centralization, of all banks by an evolution out of our clearing-house experience.
2. Protection of the credit system of the country from the domination of any group of financial or political interests.
3. Independence of the individual banks, national or state, and uniform treatment in discounts and rates to all banks, large or small.
4. Provision for making liquid the sound commercial paper of all the banks, either in the form of credits or bank notes redeemable in gold or lawful money.
5. Elasticity of currency and credit in times of seasonal demands and stringencies, with full protection against over-expansion.
6. Legalization of acceptances of time bills of exchange in order to create a discount market at home and abroad.
7. The organization of better banking facilities with other countries, to aid in the extension of our foreign trade.

The passage of legislation incorporating the above objects would directly affect the prosperity of all sections and classes of people in our country. For this reason it should be the duty of every citizen to aid the League by contributions and by influence among his neighbors. You may become a member of the League upon payment of one dollar. The proceeds of this membership fee will be devoted exclusively toward defraying the expenses of the campaign. Send your remittance to

THE TREASURER,
National Citizens' League,
223 W. Jackson Blvd.,
Chicago, Ill.

A section of the League is formed, or will be formed, in each State. If you prefer, send your remittance to the Treasurer of your State Section.

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and others to be named.

In the League's handbook, Dr. Willis strongly opposed counting the notes of any central organization, which might be created, as legal reserves of member banks (a view shared by Professor Laughlin). I was firmly of the opinion that it should be lawful for member banks to count such notes as reserves. When the handbook appeared, I was, of course, much chagrined to find that an organization of which I was one of the god-fathers and active members had, through its official organ, expressed views to which I was so much opposed. The difference of views between Dr. Willis and myself, however, concerned a subject on which we both had strong convictions, and I respected him for standing by his guns, as I hoped he respected me for standing by mine.

During the year 1911, the campaign for monetary reform made the most satisfactory progress. On November 21st, the American Bankers' Association, at its meeting in New Orleans, endorsed the Aldrich Plan. At this conference, Senator Aldrich delivered an excellent address which has already been referred to on page 67. I followed him with an address on "Circulating Credits and Bank Acceptances." [1] In this address I presented a long argument for permitting national reserve notes in the tills of member banks to be counted as lawful "reserve money." [2] At that time, Senator Aldrich was still opposed to such a provision, and so likewise was general opinion.[2]

The Financial and Commercial Chronicle of November 25th, 1911, contains a brief report on the session of the American Bankers' Association at New Orleans.[3] This report shows a very just appreciation of the importance of the educational work done by Senator Aldrich. A reprint follows:

[1] See *Circulating Credits and Bank Acceptances*, The Commercial and Financial Chronicle, December 2, 1911; *Essays on Banking Reform in the United States*, Proceedings of the Academy of Political Science in the City of New York, Vol. IV, No. 4. See also Vol. Two, p. 219.

[2] See editorial columns, *The New York Times*, November 22, 1911.

[3] *The Financial and Commercial Chronicle*, November 25, 1911, Vol. 83, pp. 1420–1421.

Our financial problems are likewise being put in the way of a solution. The American Bankers' Association has been in session this week at New Orleans, and its proceedings have attracted almost as much attention here as if the convention had been held at this point. The reason for the interest felt in the gathering is that the deliberations of the convention proper (as distinct from the several section meetings) were given up almost entirely to the discussion and consideration of ex-Senator Aldrich's Plan for the reform of the country's banking and currency system. Senator Aldrich himself addressed the convention, and there was a symposium of papers and addresses treating of every phase and aspect of the question. The criticisms in nearly every case were favorable; even where exception was taken to particular features of Mr. Aldrich's proposal, there were highly flattering remarks concerning the plan itself. We shall print all the papers and addresses delivered before the convention and before the trust company section and the savings bank section in a special supplement next week, making it possible for the reader to study them and always to have them at hand for reference.

Whether the Aldrich Plan shall ever find its way upon the statute books or not, Mr. Aldrich's achievement in having been able to propose a scheme which has evoked such a universal chorus of praise will always rank high. . . . The campaign which Mr. Aldrich, together with two or three other men connected with the National Monetary Commission, has been carrying on since last January has been educational in the highest degree. We believe we are safe in saying that in no equal period of time in the country's history has so much progress been made in promoting sound views regarding banking and currency. And the American Bankers' Association, in giving such conspicuous prominence to the subject has helped still further to vitalize the problem and to advance the work of educating the public, the bankers themselves, and the country's legislators and politicians. Surely, out of all this much good for the public weal must result in the end.

The National Citizens' League continued its work until 1914. There is no doubt that its campaign enjoyed a high measure of success. Through its efforts, supporting those of Senator Aldrich, the majority of the business and banking communities, as well as a large portion of the press of the country, were converted to the thought that the principles of the Aldrich Plan should be embodied in legislation. However, the political situation made favorable action by Congress impossible. Senator Aldrich, nevertheless, clung to the hope that by submitting his recommendation to Congress with the unanimous endorsement of the Monetary Commission, a bipartisan body, it would be possible to secure for it nonpartisan consideration. Unfortunately, the Senator's friends were unable to prevail upon him to abstain from submitting the bill in his own name. It was a matter of great doubt whether the Democrats in Congress would be willing to give to a Republican President the prestige which would come from an accomplishment so monumental as the enactment of this important piece of legislation. Certainly, it was not to be expected that they would endorse a bill which carried the name of the outstanding Republican leader.

As time went on, the chances for an unbiased consideration of the bill by Congress grew more and more unfavorable. The "Money-Trust" investigation, under the whip of the energetic Samuel Untermyer, kept the country stirred up, and the rift between Roosevelt and Taft became more and more pronounced. A growing number of leaders of the Citizens' League became convinced that, in these circumstances, the Aldrich Bill could not pass, and some of them raised the question whether the time had not come when either they, individually, or the League itself should submit a substitute plan which, while observing the principles upheld by the League, would give the legislative proposal an outward form so different that it would become acceptable to both parties. It was decided, however, that the League should continue its

policy of merely endorsing principles, and *that neither the League nor its leaders should endorse or propose any definite plan.* It was felt, furthermore, that, should the Democrats prevail at the polls, the lead would have to be left to them for the formulation of their own plans. All that we could aspire to attempt at that juncture was to prevent the Republican, the Progressive, and the Democratic parties from committing themselves in their platforms to any statements which would render banking reform on sound principles impossible. The efforts of the League during the last period of its existence were concentrated on this particular matter.

An amusing incident occurred in connection with an effort to explain the Aldrich Plan to ex-President Roosevelt. In January, 1912, the *Outlook*, with which he was then connected, sent out invitations for a luncheon at which the pending banking and currency legislation was to be discussed. Some twenty bankers and economists, as I recall it, were assembled around the table; I was one of the guests and sat next to Mr. Roosevelt. Two things impressed me immediately: (1) the lack of information with which Mr. Roosevelt approached the subject, and (2) the amazing keenness and rapidity with which he filled in the gaps in his knowledge of the matter. It was fascinating to see him interrupt the speakers and drive straight for the important points. After a comparatively short, quick fire of searching questions, it seemed that he had obtained a perfectly clear picture of the problem involved. Among those present was Mr. Morawetz, who expressed his views to the effect that a central-bank scheme was, from the point of view of theory and practice, the better scheme; but that it was politically undesirable, and that its main weakness lay in the fact that it would be impossible for the United States to produce the management required for such an undertaking—men who would be experienced and independent enough and, at the same time, willing to sacrifice the opportunities offered by other careers

in order to accept a government position of the type involved. Mr. Roosevelt said, laughingly, "Why not give Mr. Warburg the job? He would be the financial boss, and I would be the political boss, and we could run the country together." A general outburst of hilarity followed this remark.

As we disbanded, the consensus of opinion among those whose impressions I could gather was that, so far as one could draw conclusions from Mr. Roosevelt's final questions and from the general trend of the discussion, he had been fairly well won over to a favorable consideration of the Aldrich Plan, or, at least, its broad underlying principles. All the keener was our disappointment when we saw that the platform of the Progressive party, as adopted in Chicago on August 7th, 1912, contained the following section:

Improvement of the Currency

> We believe there exists imperative need for prompt legislation for the improvement of our national currency system. We believe the present method of issuing notes through private agencies is harmful and unscientific. The issue of currency is fundamentally a government function and the system should have as basic principles soundness and elasticity. The control should be lodged with the government and should be protected from domination or manipulation by Wall Street or any special interests.
>
> We are opposed to the so-called Aldrich Currency Bill because its provisions would place our currency and credit system in private hands, not subject to effective public control.

The monetary reform plank of the Taft wing was colorless and non-committal; it abstained from endorsing the Aldrich Plan. It is safe to assume that this was not due to any lack of sympathy with the plan itself, but arose from a realization of the fact that, if non-partisan consideration of banking reform was to be secured, the worst that could happen would be to make the plan a party measure.

While the work of the Citizens' League had been successful in some Democratic sections as, for instance, in Alabama, where the Underwood wing had endorsed the principles of the Aldrich Plan, the Democratic platform, as printed, proved most disappointing. It contained the provision: "The Democratic party is opposed to the Aldrich Plan or a central bank." At the time, it was widely stated that the plank, as adopted by the Democratic Convention, read "the Aldrich Plan *for* a central bank," and that, when the document was printed, either by inadvertence or by a Machiavellian trick, it was made to read "the Aldrich Plan *or* a central bank." Whatever the truth may be, the Chairman of the House Committee on Banking and Currency, Mr. Glass, who, later on, was charged with the formulation of a new plan, adopted the second version as binding upon himself.

As the presidential campaign of 1912 advanced, Democratic members of the Citizens' League, some of whom enjoyed friendly relations with Woodrow Wilson, tried in vain to have him express his views concerning the principles on which monetary reform should be based. Mr. Wilson remained silent and a puzzle to all. His views did not become publicly known until the Glass Bill was fairly well advanced.

Early in 1910, Senator Aldrich had announced that, at the expiration of his term, in November, 1912, he intended to withdraw from active political life. His bill was introduced in the Senate on January 9th, 1912, but, in view of the conditions which then prevailed, it was thought inadvisable to push it any further.

While the Aldrich Bill thus failed to become law, it would nevertheless be a great injustice to deny its author credit for the invaluable service he rendered by boldly cutting loose from the antiquated principles on which American banking legislation had until then been resting and in proposing a plan which was recognized as constituting so great an advance that even its defeat made it inevitable that any substitute plan

would have to adopt many of its principles and essential features. When Senator Aldrich revised his original views on the banking problem and in a radical way reversed the policy of the great political party of which he was so prominent a leader, he showed extraordinary courage and vision for which the country owes him an everlasting debt of gratitude.

CHAPTER V

FIRST DRAFTS OF THE GLASS BILL

(1913)

AFTER the success of the Democrats in the fall of 1912, the country waited anxiously to see what would be the course of banking reform. One wondered, in particular, if Mr. Glass, the future Chairman of the House Committee, would begin the work *de novo* (or rather *ab ovo*), or whether he and his Committee would proceed from the point at which the National Monetary Commission had stopped. For some time, however, Mr. Glass allowed little or nothing to become public, and the President-elect maintained complete silence on the subject.

During the period between Governor Wilson's election and his inauguration, when the banking reform plans of the Democratic party were still entirely undefined as far as the public knew, a good many people came to me for information on the subject. This was especially true of those who were likely, in some way or other, to be appointed by the new Administration to positions of responsibility, such as Mr. McCombs, Mr. McAdoo, and Mr. Henry Morgenthau. Some months before the election, I had been invited to meet Colonel Edward M. House and, in the course of the year, I met Senator Owen and many members of both Houses of Congress. To all of them I freely expressed my opinions, just as I did to Chairman Glass when the Federal Reserve Bill began to assume tangible form.

Among the first of the above mentioned gentlemen was Mr. Morgenthau, who had played a very prominent and loyal part in the Democratic election campaign. He asked me to prepare for him a plan which, while observing the main princi-

ples of sound banking reform, would be compatible with the tenets of the Democratic party as embraced in their platform. A rough draft of such a plan was given to him by me on December 7th, 1912. It provided for a reserve bank which would have its central office in Washington, with some twenty branches in various parts of the country and with provision for increasing the number of those branches, or for the creation of sub-branches, as further developments might require. In general, the powers to be enjoyed by such an institution were about the same as those which had been given to the proposed National Reserve Association in the Aldrich Bill. The plan provided, however, for a measure of strong government control, with almost direct government ownership of the bank, which would indirectly make the circulating notes issued by the bank government obligations. The Democratic doctrine would thus have been respected without a surrender to extreme demands.

This draft was prepared some three weeks before December 26th, 1912, the day when the President-elect was consulted by Mr. Glass on the question of banking reform. None of us knew what was running through Mr. Glass's mind or whether *any* feature contained in the Aldrich Plan was to be taboo just because it was so included. Lacking any indication regarding the direction in which those now in control would move, all suggestions concerning the external structure of the new system were, of course, of very little value and were bound to remain so until more definite information was made public by the Democrats.

The first rumor that reached us was that Mr. Glass was working on a system of regional banks. How far, at that time, the Democrats planned to carry the regional idea was not, and has not yet been, told, although it was stated that Mr. Bryan wished to start with fifty regional institutions.[1]

[1] Dr. Willis states in his book *The Federal Reserve System*, p. 580: "In the first instance, the idea of an unlimited number of reserve banks had first been

It was, of course, more or less plain to all careful students that, if a workable system was to be produced, the separate reserve banks then under discussion would, in some way, have to be connected. If the plan was to be acceptable this was inevitable, even though the independence of the regional banks was to be the outstanding feature of the scheme and its main divergence from the Aldrich proposal. Inasmuch as it was out of the question to make one superman the financial dictator of the whole United States, and as the Democratic platform made it impossible to provide for the regional banks an organic connection, such as had been devised in the Aldrich Plan, the creation of a Board was, in the end, the only possible solution.

As Mr. Glass has since stated in his *Adventure in Constructive Finance*, he had originally planned that the only connecting link between the various regional banks should be the Comptroller of the Currency. Those who know Mr. Glass's conservative temperament, however, will find it difficult to believe that he intended to give to this one individual the wide powers which, later on, were vested in the Federal Reserve Board. Had he done so, he would have created an autocrat with greater powers than the American people have ever vested in a single person. The Comptroller of the Currency, a political appointee, would, under such conditions, have been empowered to force one reserve bank to rediscount for another, to review and determine the rediscount rates, to regulate the open-market transactions of the various banks, as well as to exercise the rest of the one hundred and twenty-seven "powers and duties" (as listed by Mr. Charles S. Hamlin of the Reserve Board) with which the Board is endowed to-day for the purpose of holding the System together. It must, therefore, be assumed that Mr. Glass, at the outset, had in

broached, the thought being that eventually one would be established at every point where local banking interests desired it and were able to furnish the resources for a strong enough institution."

mind only that the Comptroller should exercise supervisory powers. In other words, he must have started, as other financial reformers before him had done, with the idea of a large number of independent and entirely disconnected central banks. Inasmuch as he had not provided for a limitation of the dividends payable to stockholders, these banks, had they been called into existence, would have entered into keen competition with one another.[1]

The regional idea, which has not infrequently been put forth as a distinctive characteristic of the Federal Reserve legislation, did not originate with Mr. Glass or Dr. Willis. As has already been mentioned, a system of disconnected sectional reserve banks had been suggested by Mr. Victor Morawetz as early as the year 1909 and again in January, 1911. (See footnote on page 36.) When Mr. Morawetz introduced the regional plan, my attitude towards it was sympathetic, provided the decentralization did not go too far and provided also that it contained some means of joining the regional banks together. During the next three years, I expressed my views concerning regional banks repeatedly. Again, in January, 1913, before the sub-committee of the House Committee on Banking and Currency, commonly known as the Glass Committee, I made public my views on the subject. (See Appendix Three.) In this connection, the following quotation from my article, "A United Reserve Bank of the United States," which was published in 1909, may not be without interest:

[1] Dr. Willis in *The Federal Reserve System*, p. 147, quotes a letter which Mr. Glass addressed to him on December 29th, 1912, after the conference between Mr. Glass and Mr. Wilson. This letter contains the following highly significant passage:

"Very likely you will recall my remark that, speaking for myself, I would cheerfully go with the President-elect for some body of central *supervisory* control, if such a body can be constituted and divested of the practical attributes of a Central Bank. In my judgment this is the point of danger. This is where the bombardment will be directed. If we can devise a superstructure or, to use Mr. Wilson's phrase, 'a capstone,' for the plan we have, as it shall be revised, it would be well to be prepared for that emergency."

Mr. Morawetz's plan contains two suggestions: one, as we have seen, being the regulation of reserves against note issue, and the other being the creation of sectional reserve banks. It is greatly to be regretted that Mr. Morawetz has emphasized the first scheme and touched only slightly upon the second. It is sincerely to be hoped that he will work out in detail this plan for sectional reserve banks, which he desires to be at all times in a position to furnish reserve money to the several banks in their sections by paying checks drawn against the deposit accounts of the banks or by rediscounting paper offered by them for that purpose.

I am confident that Mr. Morawetz will soon reach the conclusion that these sectional reserve banks must be endowed with all the powers and charged with all the duties given under our plan to the United Reserve Bank branches; otherwise they will be nothing but safe-deposit vaults which will have to hold for each bank the exact amount of cash received from it for safekeeping. They cannot go a single step further without incurring the gravest danger unless they have some central bank to fall back upon, or unless they are themselves central banks, that is to say, disconnected central-bank branches. Mr. Morawetz tries to cover the weakness of decentralized reserves by providing that the several sectional reserve banks be authorized to make arrangements with one another in order to facilitate exchanges between different sections of the country. But there must be more than this authority to make arrangements with one another with a view to facilitating these exchanges. These sectional reserve banks must in the end act as a unit. Otherwise we shall have a recurrence of our experiences of the end of 1907 when one reserve center closed itself against the others, etc. . . . Should a common foe attack Boston and New York, would Illinois keep her soldiers at home, or would she differentiate between Boston and New York? The knowledge that all will stand together gives a feeling of confidence and safety. It is the same with our financial reserves; they must be held united under one direction, to be thrown where they are needed, and

to be withdrawn from places where they are superfluous. . . .

There must be one big reserve, one note-issuing power, one big bank, which will be neutral, administering impartially and economically the funds of the Treasury of the United States, and issuing notes that are good enough, not alone for the people, but also for the banks to be counted as cash. Instead of 20,000 institutions carrying an average of 8 per cent cash against their deposits and notes, what we need is one big institution with a capital of $100,000,000, acting as reserve for all and maintaining a normal reserve for its notes and deposits alike of probably 80 per cent instead of 8 per cent. . . .[1]

By 1912, regional plans were comparatively common. Almost two years before the passage of the Federal Reserve Act, I wrote the following letter to Mr. J. H. Cowperthwait, New York, in response to an article he had published in November, 1911, entitled "Separate Reserve Associations, A Substitute for the Aldrich Plan."

New York, N. Y. January 12th, 1912

MR. J. H. COWPERTHWAIT,
NEW YORK, N. Y.

MY DEAR MR. COWPERTHWAIT:

I am greatly indebted to you for sending me your pamphlet, entitled "Separate Reserve Associations," and for the flattering dedication which you have written into it.

[1] Mr. Morawetz abandoned his proposal for the creation of sectional reserve banks, to be administered substantially as local central banks, and, in a paper published in January, 1911 (Academy of Political Science in the City of New York, Vol. I, No. 2), he recommended a system of divisional banks linked together by a central association. In this article he stated that his plan was merely an adaptation to conditions existing in the United States of the underlying principles of a central bank. Two years later, on October 20th, 1913, when Mr. Morawetz appeared before the Senate Committee, he recommended that no more than five or six reserve banks be organized. Thus, starting with views wide apart, we had both reached substantially the same conclusions. After the publication of *An Adventure in Constructive Finance*, Mr. Morawetz, on April 5th, 1927, wrote a letter of protest to Senator Glass. Mr. Morawetz sent me a copy of this letter, and with his permission it is published herein as Appendix Eight.

> While I do not agree with you, your point of view is certainly interesting, and the discussion of the problem from the opposite side can only be helpful in crystallizing the views.
>
> I am frank to say that you have not shaken my conviction, which is that separate reserve associations will not prove successful. The function of a reserve association, to protect a country against gold withdrawals and other adverse effects, cannot be carried on by separate associations, which would not, as you point out yourself, have the same point of view, nor be governed by the same conditions at the same time. The accumulation of foreign exchange and its resale at a given moment could not be carried on by scattered associations; there must be one large and single point of view and cooperation by all, for the benefit of all, if the plan is to succeed. If you unite your scattered associations under one head and make them coöperative you will have to make this cooperation so strong as to again produce one single system, such as the National Reserve Association; if you leave the cooperation between the scattered associations indefinite and loose, you will have a scramble for reserves in times of need and a gold premium between those various centers in case of crises, and you will not have a united front in facing the enemy at home and abroad.

Approximately a year before the hearings of the Glass Committee began, my attitude toward a regional scheme was publicly expressed in a report which, as chairman of a subcommittee on Banking Reform, I presented on February 19th, 1912, to the Republican Club of the City of New York.[1] In this report, the following statement was made:

> It might, however, be opportune to emphasize this point for the benefit of those critics who believe that the solution of our monetary problem would best be found by creating separate reserve associations, for which some plan of co-

[1] The report is reprinted herein as Appendix Nine. It is interesting to observe how much of it might just as well have been written as an endorsement of the Reserve System.

> operation has been very vaguely suggested. Your committee believes that either a very rigid plan of coöperation will have to be worked out, in which case it would result in a scheme substantially the same as the National Reserve Association or if these reserve associations were to remain fairly distinct units, the most important advantage from the National Reserve Association would be lost.

It is idle to conjecture whether or not Mr. Glass and Dr. Willis, the Committee's expert, were familiar with these discussions. The facts are related here for the purpose of showing how obvious it was, long before the preparation of the first draft of the Glass Bill was begun, that disconnected regional reserves could not accomplish the desired end, and that, if they were satisfactorily tied together, a central banking system would result. Of course, as shown by the ultimate provisions of the Federal Reserve Bill, Mr. Glass himself finally arrived at this point of view.

Early in January, 1913, the Glass Committee began its hearings and, together with Mr. A. Barton Hepburn, Mr. Victor Morawetz, and some of my associates of the Citizens' League, I was invited to appear before it.[1] Those testifying at the hearings of the House Committee were, of course, anxious to find out from Mr. Glass just how far he felt the Democratic platform precluded him from adopting the general principles and some of the details embodied in the Aldrich Plan. The trend of our examination left no doubt that a new form of structure was considered a fundamental requirement. Those of us who urged a plan involving the centralization of reserves and note issue were confronted with the stereotyped question whether or not we had read the Democratic platform, and thus soon realized that the Democratic party was definitely committed against "the Aldrich Plan or a central bank." The

[1] A statement I presented to the Glass Committee in the course of my testimony on January 7th, 1913, appears herein as Appendix Three.

matter was further clarified when, in the course of my testimony, the following statement was made by Mr. Glass:

> I have not meant to imply that the Democratic party intended to denounce anything that is good in the Aldrich Plan or to restrict its representatives in Congress from adopting anything that is good in the Aldrich Plan; but if the declaration of the party platform was not primarily against the central reserve feature of the Aldrich Plan, I do not know what is meant by denouncing the Aldrich Plan.

While, as a matter of loyalty to the work done in coöperation with Senator Aldrich, I tried in my testimony to advocate a central reserve system in a somewhat modified form, the alternative of a regional plan had been freely discussed among the leaders of the Citizens' League. At the hearings before the Glass Committee, Mr. John V. Farwell, the President of the League, and Professor J. Laurence Laughlin, its chief executive, both offered regional plans. Mr. Farwell proposed, in general terms, a regional plan with "five, or at the most seven, district associations" with a "central cooperative board." Professor Laughlin, who had long been anxious to submit a substitute for the Aldrich Plan, presented a bill worked out in the fullest detail. It was a plan for six regional associations with a "Central Treasury Board of thirty members appointed by the regional associations and . . . *ex officio* members to be appointed by the President."

After the House Committee hearings had established the fact that no scheme would be considered seriously by Mr. Glass and his colleagues unless it embraced the regional reserve bank principle, I at once revised the plan which I had outlined for Mr. Morgenthau a month earlier, suggesting that, instead of having a single central institution, the United States be divided into four zones with a bank in each.

These four regional reserve banks were to be mutually responsible for each other and their profits and losses were to be pooled in proportion to the capital they represented.

There was to be an issuing department at Washington, which would issue notes under the joint responsibility of the four regional banks. This issuing department could issue notes only as long as the joint status of the four regional reserve banks showed a cover of no less than 33⅓ per cent in gold and the balance in commercial paper.

There was to be established at Washington a *Board of Regents*, to consist of the governors of the four regional reserve banks, four in number, the Secretary of the Treasury, the governor and vice governor of the issuing department at Washington, and four members, one from each region (not being bank or trust company officers) to be appointed by the President of the United States.

The Board of Regents was to have supervisory and veto powers over the regional banks. It was to publish twice a month the condensed statement of the four regional reserve banks; it was, from time to time, to fix discount rates and to establish a general policy concerning the investment or sale of foreign exchange and the purchase or sale of United States Government bonds and Treasury notes.

A system of free transfers of balances from one branch to the other was to be worked out, regulating "exchanges between cities." "This will not be as easy," the memorandum stated, "as under the previous United Reserve Plan; the operation will necessarily be more complicated, but it can be done, if that is the price for securing otherwise perfectly adequate legislation."

The memorandum embodying this revised plan was sent to Mr. Morgenthau on January 10th, 1913; copies were sent likewise to Colonel House and to Dr. Willis. I have Mr. Morgenthau's assurance that he sent his copy of the memorandum to President Wilson.[1]

[1] Inasmuch as all these plans were submitted fully three months before the Willis Digest of the first draft of the Federal Reserve Bill was written, it is very difficult to understand exactly what Dr. Willis had in mind when, in

These details are related not in an effort to determine the origin or authorship of the plan of regional banks with a controlling board. They are given here merely to show that in the opinion of all those who were engaged upon the work of devising a bill in accordance with the Democratic platform there was no course to pursue other than the one embracing regional divisions with a central board of control. Mr. Glass has said that, in his first interview on banking reform with Mr. Wilson, on December 26th, 1912, when he and Dr. Willis spent two hours outlining a divisional plan to Governor Wilson, the President-elect towards the end announced that they were "far on the right track" but "offered quite a few suggestions, the most notable being one that resulted in the establishment of an altruistic Federal Reserve Board at Washington to supervise the proposed system."[1] Some commentators have gone so far as to call President Wilson the spiritual father of the Federal Reserve Act on account of this suggestion. That is overstressing his contribution. A controlling board was the inevitable consequence of a regional scheme, and President Wilson could not possibly have escaped a conclusion which so many other students of the problem had been forced to reach.

The first definite suggestion of what Mr. Glass had in mind in the way of a bill came to me during the latter part of April, 1913. Colonel House at that time sent me a Digest of the proposed Glass Bill, which had been prepared by Dr. Willis upon the President's demand and given to Colonel House by the President.[2] I did not know at that time how the Digest had passed into Colonel House's hands; he transmitted it to me with the simple request that I analyze it for him as quickly

The Federal Reserve System, p. 523, he wrote that the Federal Reserve Act "was not derived from, or modelled after, or influenced even in the most remote way by other bills or proposals currently put forward from private sources, but, on the contrary, it was itself the pattern from which a host of imitators sought copy."

[1] Glass, *An Adventure in Constructive Finance*, p. 82.

[2] *See* Glass's "*Adventure*," p. 49.

as possible. I believe my reply had to be given within twenty-four hours. Such short notice did not permit me to make my analysis as clear and concise as it should have been, but I could not delay the answer, for I surmised, and subsequent events have revealed my surmise as correct, that the analysis was for the immediate information of the President.[1]

It is to this analysis of mine of April 22nd, 1913, transmitted to Mr. Glass by Secretary McAdoo on April 27th, 1913, that Senator Glass refers in *An Adventure in Constructive Finance*, page 49, when he speaks of a "hostile criticism . . . , calling for radical alterations of the bill, which were not made, and advocating certain things which were not done." An elaboration of this thought may be found in another passage on the same page, reading as follows:

> He simply was unalterably hostile to certain fundamental provisions of the federal reserve bill and in plain terms persistently said so. This he had said at the committee hearings in January, which made it quite futile to have him repeat it in April. . . .

Inasmuch as my analysis of April 22nd, 1913, pertained to the Willis Digest of the Glass Bill, a bill which was not in existence when I testified before the Glass Committee on January 7th, 1913, Senator Glass's statement that in January I criticised the fundamental provisions of the Federal Reserve Bill cannot be explained except upon the assumption that he had not refreshed his memory when he wrote that statement. This assumption would also explain his misconception and misstatement concerning the analysis itself. A study of my communication (See Appendix Eleven) will show that the critical analysis given therein, while frank, was written in a

[1] The Digest, *i.e.*, Dr. Willis's Memorandum on Scope and Effect of H. R. —, and my analysis of it appear herein as Appendix Ten and Appendix Eleven respectively. Both are recommended to the careful attention of the reader.

constructive, rather than a hostile, spirit, and that, instead of "calling for radical alterations, which were not made, and advocating certain things which were not done," the paper contained no less than nine suggestions which appear, either wholly or in part, in the Federal Reserve Act as passed by Congress. The subject is perhaps of sufficient historical interest to justify citing the instances.

1. According to the Willis Digest of it, the draft of the Glass Bill, as submitted at that time, provided for twenty Federal reserve banks [1] "*with possible increase later, as provided.*"

In my analysis, I made the following statement:

"You can readily see that if you had fifty independent reserve centers, the plan, for many obvious reasons . . . would be an impossible one. If you had three, four, or five, I could see that you could develop a desirable plan. I mention the large number of fifty, in order to show that this is not a question of theory, but of practical application."

Further, in closing my argument for a reduction of the number of reserve banks from twenty to four or five, I stated: "A definite and national policy can be developed by so small a number of units and it can be carried out . . . a proceeding which is practically impossible with a larger number. If this point of view be adopted, which I do not think is contrary to the principle of the law as drawn at present, I think a very creditable measure may be developed. It may even have some advantages over the Aldrich Plan, because it is possible that these three or four units, if need be, may have different rates of discount, while in the Aldrich Plan the one rate for the whole country may prove embarrassing at times."

The Act as passed by Congress provided for "not less than eight nor more than twelve" regional banks. That Mr. Glass

[1] In the Willis Digest, reserve banks are termed "National Reserve Banks." In order to avoid confusion, we have changed this designation in quoting from Dr. Willis' Digest, calling them by their later title, that is, Federal reserve banks.

came to appreciate the advantages of a smaller number of banks is shown by his statement that he had "hoped the Federal Reserve Board Organization Committee would start the system with the minimum number [1] of regional banks." In any case, a reduction from twenty or more to a final minimum of eight and maximum of twelve evinced progress in the direction advocated by me.

2. The Willis Digest stated: "*Ownership (of the Federal reserve banks) to be in the hands of the national banks;*" . . . and again "*It has not been thought wise to permit state banks to own stock in the Federal reserve banks.*"

In my analysis I pointed out that this would be a mistake, and said:

"The basis of the Federal reserve banks ought to be as broad and as strong as possible, and . . . national banks, state banks, and trust companies should be admitted to the privileges of the new organization on equal terms, provided they submit to certain rulings as to their reserves and to supervision, and on equal terms as to the holding of stock of the Federal reserve banks."

The Federal Reserve Act as passed by Congress followed these recommendations.

3. According to the Willis Digest, the first draft of the Glass Bill provided that "*Federal reserve banks would be allowed to issue notes . . . to an amount equal to twice the par value of their capital stock.*"

My analysis stated: "I think any limit . . . is inadvisable and dangerous, because whenever the limit is being approached helplessness stares the country in the face, and a panic may ensue."

The Act in its final form removed any such limitation.

4. On the other hand, in connection with the foregoing provision of the tentative bill, I proposed that the notes be

[1] *See* Glass's letter to Delano of November 13th, 1915. *An Adventure in Constructive Finance*, p. 260. *See also* Appendix Twelve.

limited only by a prescribed gold reserve, and suggested 33⅓ per cent.

The Federal Reserve Act as passed by Congress provides that, in addition to the commercial paper against which notes are issued: "Every Federal reserve bank shall maintain reserves in gold . . . of not less than forty per centum against its Federal reserve notes in actual circulation, and not offset by gold or lawful money deposited with the Federal reserve agent and thirty-five per centum against its deposit liabilities."

5. In connection with the disposition of the United States bonds against which, under the National Bank Act, national banks were allowed to issue their own notes, the Willis Digest stated: "*Banks now holding the bonds may offer these bonds for redemption or conversion into three per cent bonds at a rate not to exceed one-tenth of their holdings each year. . . . At the end of ten years other holders of bonds would be allowed to convert them into 3s.*"

In my analysis, I maintained that this was a weak plan for several reasons. As a substitute, I suggested a plan which, in principle, was followed by the Federal Reserve Act.

This is the one recommendation of mine which Senator Glass admits to have been embodied in the Federal Reserve Act.

6. The Willis Digest stated that the proposed bill contained a provision for the "*transfer of reserves from existing national banks in reserve and central reserve cities, to Federal reserve banks.*"

My analysis stressed the point that the proposal was objectionable in so far as it provided that reserve balances with reserve agents in reserve and central reserve cities were to be converted into cash or into balances with the reserve banks. That would have led to enormous credit contraction, unless the member banks had at once recouped themselves by rediscounting with the reserve banks an aggregate approximately equalling the total amount of balances so withdrawn from reserve agents. This was plainly undesirable, and if only cash in

vault and balances with reserve banks were to constitute the future lawful reserve of member banks, then the alternative was a corresponding reduction of the reserve requirements so that, while balances in reserve and central reserve cities were to be outlawed as legal reserves, the balances themselves would not be violently disturbed.

In keeping with the thoughts here expressed, the first draft of the Glass Bill was changed, and the Federal Reserve Act ultimately provided for a reduction of the required reserves from 15 per cent, 25 per cent, and 25 per cent—to 12 per cent, 15 per cent, and 18 per cent for country banks, reserve city banks, and central reserve city banks respectively.

7. The Digest had it that the draft of the Glass Bill allowed only fourteen months for completing the process of transferring the reserves into the reserve banks.

In my analysis I said, "fourteen months is a very short time to adjust conditions."

In the Federal Reserve Act, the period was lengthened to thirty-six months.

8. The Willis Digest stated that the draft of the proposed Glass Bill provided for the paying of interest on government deposits.

In my analysis I said, "I doubt the wisdom of allowing interest to the Treasury on its deposits."

The Federal Reserve Act did not provide for the payment of such interest.

9. The Digest did not mention any limitation of the dividends which might be paid to stockholders.

In my analysis I stated that this limitation was "absolutely necessary."

In the final draft of the Act dividends were limited to 6 per cent, and excess earnings beyond 6 per cent, after the allowance of a certain surplus to the reserve banks, were to go to the United States Government as a franchise tax.

My analysis of the Willis Digest was written on April 22nd,

1913. A month later, on May 21st, I sailed for Europe and, quite unexpectedly, found Colonel House a passenger on the same boat. I remember that I spoke to him about a conference I had had with Mr. Untermyer and Senator Owen at the former's invitation, on May 18th, three days before my sailing, at which I had been interrogated at great length on questions of monetary reform. Both Mr. Untermyer, who was carrying on the "Money Trust" investigation at that time, and Senator Owen, who was the prospective Chairman of the Senate Committee on Banking and Currency, had shown a deep interest in the subject. I informed Colonel House that Senator Owen had indicated the rough outlines of a bill which he had drawn up and which tended strongly in the direction of creating a government agency for the issuing of currency, and that Senator Owen had tried to convince me of the superiority of his scheme over the Aldrich Plan or over a plan such as he seemed to believe to be under consideration by Mr. Glass. I also told Colonel House that, at the end of our long discussion, I had explained to Senator Owen that I could not endorse his advocacy of an absolute government control of the issue of money, and that I believed a sound and practical regional plan could be evolved, observing the main principles of the Aldrich Plan, provided decentralization did not go too far.

Colonel House, in turn, showed me in confidence a plan which had been given to him with the request that he express an opinion concerning it. He asked me to study this anonymous bill, which I surmised had been prepared by either Mr. McAdoo or Mr. John Skelton Williams, or both. As a matter of fact, in his book *The Federal Reserve System*, Dr. Willis mentions these two gentlemen as the authors of it.[1]

During this voyage to Europe on the *Mauretania*, I wrote a memorandum in which I tried to disabuse the minds of Mr. Untermyer and Senator Owen of the views they had expressed in their talks with me, adding at the end an argument against

[1] Willis, *op. cit.*, ch. XI, p. 195.

the anonymous bill that had been shown to me in confidence by Colonel House. This document I sent to Mr. Untermyer, asking him to pass it on to Senator Owen.[1] Colonel House received a copy of this *Mauretania* memorandum and seemed in entire sympathy with it. I felt confident at the time that he would send my adverse criticism of the anonymous bill "back home" to headquarters. Evidence since published shows that I was correct in this assumption. It is not impossible, therefore, that my *Mauretania* memorandum criticizing the "anonymous bill" may have been helpful in breaking down the efforts of Mr. Glass's opponents.

To the best of my recollection, I saw the "Glass Bill" for the first time some weeks after its publication in June, 1913. The first print of it reached me while I was in Europe. As published, the bill showed certain improvements over the Willis Digest which I had seen earlier. One of the encouraging changes was the reduction of the number of reserve banks from twenty to fifteen. Some of the major changes, however,

[1] My letter to Mr. Untermyer enclosing the *Mauretania* memorandum for Senator Owen will be found in Appendix Thirteen. For the memorandum itself, see Appendix Fourteen. These documents have been reprinted here as part of the evidence for close students of the subject; the ordinary reader may safely pass them over.

Senator Owen, in his book, *The Federal Reserve Act*, pp. 81–83, (Century Company, New York, 1919) refers to my talk with him as follows:

"I recall spending seven consecutive hours discussing with Mr. Paul Warburg the question of whether the Reserve notes should be the notes of the United States Government or bank notes, he taking the position that they should be notes of the Federal Reserve banks and not United States Treasury notes, he contending that these notes would be the obligations of the United States and would weaken the credit of the United States when the United States came to borrow money from the banks or from the people. I took the position that the currency of the country ought to have behind it the taxing power of the nation, that the United States should control the currency, . . . and that the Treasury notes would mobilize capital, so that it would be easier for the Government to negotiate its loans with such notes operating as a medium for transfer of credits conveniently through the banks which would be stabilized by this system."

were deeply alarming and distressing. For example, the published draft provided that Federal reserve notes would be issued as "obligations of the United States," and, whereas the Willis Digest had mentioned a provision for a Reserve Board of which one-third of the membership would consist of appointees of the reserve banks, the published draft provided for a Board of seven members, all of whom were to be appointees of the President. Of these seven, three were to be the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency—a hopelessly political Board. Credit for these fatal changes has since been claimed by Senator Owen, although Dr. Willis places the responsibility on Mr. Bryan. One is inclined to assume that they shared honors equally. Senator Owen, in his book, *The Federal Reserve Act*, gives the following account:[1]

> The Glass tentative draft avoided the establishment of a central bank with branches, and provided twenty Federal reserve district banks under control, however, of a Federal Reserve Board, *with forty out of forty-three members chosen by the banks.*
>
> Section 10 of this draft provided for a Federal Reserve Board, consisting of forty members chosen by the member banks and their stockholders, and the Secretary of the Treasury, the Comptroller of the Currency, and the Attorney General of the United States. Mr. Glass, however, proposed to amend this draft to alter this provision so that the Federal Reserve Board should be selected by the directors of the National reserve banks, the directors of the Federal reserve banks being selected by the member banks and their shareholders, either directly or indirectly.
>
> I was strongly opposed to either provision because it would *not* give to the United States control of the system. In effect this control of the system I regarded as practically the same as the Aldrich Bill, which would have put the management of

[1] Owen, Robert Latham, *The Federal Reserve Act*, pp. 72–79. The Century Company, New York, 1919.

the system in the hands of persons chosen to represent the banks, and I insisted that the control of the system was a governing function to be exercised alone by the Government of the United States. . . .

Mr. Glass and myself discussed the matter very freely and fully, but could not reach an agreement. As far as he felt it safe to go was to have a Federal Reserve Board of seven, four members of which were to be chosen by the Government and three by the banks.

Upon this vital difference we determined to appeal to the President. We had a hearing one night at the White House, in the Cabinet Room, Mr. Glass urging his view and I pressing the proposal that the Government should control the appointment of every member of this Board. After a discussion of two hours, approximately, *the President coincided with my contention that the Government should control every member of the Board on the ground that it was the function of the Government to supervise this system and no individual, however respectable, should be on this Board representing private interests.*

Secretary McAdoo was present at this interview and agreed with the view which I presented. . . .

The Glass draft, Section 21, followed the Monetary Commission Bill and provided that all moneys of the general fund of the Treasury should, after six months, be deposited in the National reserve banks and disbursed through such banks.

This I was unwilling to agree to, believing that the Government should retain complete control of its receipts and disbursements as a further check on the reserve banks by the Government. . . .

Section 23 of the original proposal by Mr. Glass authorized the National reserve banks to receive from the Federal Reserve Board Federal reserve notes, but these notes were to be the bank notes of the Federal reserve banks as in the Monetary Commission Bill, and not the notes of the United States Government.

I objected to this provision, insisting that the notes should be United States Treasury notes and treated as such, for the

reason that in this way the United States Government would be able *to control* these notes and the banks would not be able to control them, and Senate Bill 2639, and House Bill 6454, introduced June 26, 1913, by Mr. Glass and myself, made such notes the obligations of the United States, to be issued at the discretion of the Federal Reserve Board solely for the purpose of making advances to Federal reserve banks (Section 17).

On this point I had the active assistance of Hon. W. J. Bryan, Secretary of State.

In a letter to Mr. Samuel Untermyer, dated May 14th, 1927, Senator Owen completes the story as follows: "I immediately called on William J. Bryan at Calumet Place and obtained his coöperation to correct this grave error on the currency of the Willis draft. He assisted me and Joseph P. Tumulty, then secretary to the President, coöperated and my views prevailed. These fundamentals being reconciled, Mr. Glass and myself, on June 26th, 1913, introduced identical bills as a basis for discussion in Congress."

The bill, with its "fundamentals reconciled," now became known as the Owen-Glass Bill.

Before Mr. Glass consented to these harmful changes, he had presented a bill which, barring a dangerous tendency towards excessive decentralization, was, in the main, sound and highly commendable. It was the victory of the Owen-Bryan wing, and the insertion of sections repugnant to the business and banking community, that caused alarm and called forth determined opposition on the part of business men and bankers.

My own impressions concerning the Owen-Glass Bill, and some constructive suggestions, were laid down in a sketch of an article which, at the end of July, 1913, I enclosed in a letter to Colonel House from Sils Maria, Switzerland, as follows:

Sils Maria, July 30th, 1913

DEAR COLONEL HOUSE:

. . . While I am up here in the mountains I have been fool enough, instead of playing, to write a short article concerning the Owen-Glass Bill and an argument for some modifications. I am sending you the original herewith and am forwarding a copy to my secretary by same mail so that he may have some clean copies made. I do not know whether I shall have the article published, because I am too much out of touch with the controversy now going on, and if I knew that there was no hurry and danger in delay, I would prefer not to go into print before my return at the beginning of September. But I have felt that I should write this argument for President Wilson and Mr. McAdoo. They cannot possibly believe that these Owen-Bryan heresies can be forced upon our poor country without the worst consequences politically and economically. I rather think that it would be welcome to them if public opinion forced them to modify the bill, which can be done, as I have tried to show, without destroying the basic thoughts of the present bill. Moreover, I think I owe it to myself to go on record with respect to this Owen-Glass Bill. . . . I shall ask my secretary to send you a few copies of my brief. I leave it to your own judgment whether I should send copies to Messrs. Glass and Owen (or whether you would conveniently do so) or possibly also to Senator Gore. Could you send me a week-end cable giving your impressions concerning my paper and your free criticisms of the same, and also telling me what I could do further in the matter. Many sincere thanks in advance. . . .

Yours very sincerely,

PAUL M. WARBURG

In answer to this communication Colonel House cabled me, on August 12th, stating that the Glass Bill, in the interim, had undergone important changes and advising against the publication of my paper. By that time, indeed, the Glass Bill, remodelled in several respects, had been endorsed by the Democratic caucus.

I then revised the Sils Maria memorandum, entitling it "The Owen-Glass Bill as Submitted to the Democratic Caucus," and from Europe I sent typewritten copies of it to Mr. Irving T. Bush and Mr. Edmund D. Fisher, with both of whom I was at that time closely associated as a member of the Citizens' League for the promotion of currency reform. Copies were likewise sent to Colonel House. Through these friends, copies of the article were forwarded to President Wilson, Mr. McAdoo, Mr. Glass, Senator Owen, Dr. Willis, Mr. Hepburn, and to the bankers—very few in number—who were being consulted by Mr. Glass and who were familiar with the status of the bill.

Colonel House's letter acknowledging receipt of the article is, perhaps, not without interest:

October 11th, 1913[1]

DEAR MR. WARBURG:

Thank you for sending me your criticisms and suggestions with regard to the Owen-Glass bill. It comes this morning, and I shall read it with a great deal of interest.

I have been consistently advising the reduction of reserve banks, and I have also advised the reduction of the ex-officio members from three to two, and an increase of the members to be appointed by the central banks[2] with a lengthening of their terms from eight to ten years so that no President can change the personnel during a single term of office. Just what will happen finally lies in the lap of the gods; but I feel sure that a currency measure of some sort will be enacted before many moons.

I wish you were here so that we could have your valuable advice.

With warmest regards and best wishes, I am,

Faithfully yours,

E. M. HOUSE

[1] The date, October 11th, 1913, seems to have been an error on the part of a clerk or secretary; it should probably have read September 11th, 1913.

[2] *i.e.*, Federal reserve banks—*Author.*

In its revised form, my article on the Owen-Glass Bill [1] was published in the *North American Review* of October, 1913, not, however, without my having first inquired of those in charge of the legislation whether publication of my criticisms and suggestions at that late date would "rock the boat" or embarrass them. The only earlier publicity that my article had received had been through an unauthorized publication of parts of it by the *Journal of Commerce*, which, through channels unrevealed to me, had secured one of the copies confidentially distributed.

In this chapter a rather full account of my relation to the Federal Reserve Bill in its earliest stages, and particularly of my connection with Colonel House in regard to it, has been given in order to refute certain statements which have been made by Glass and Willis in their respective books—statements which are misleading and which have done much to create false impressions.

[1] *The Owen-Glass Bill as Submitted to the Democratic Caucus*, North American Review, October, 1913; *Essays on Banking Reform in the United States*, Proceedings of the Academy of Political Science in New York, Vol. IV, No. 4. *See also* Volume Two, p. 237.

CHAPTER VI

FROM OWEN-GLASS BILL TO FEDERAL RESERVE ACT

DURING the summer and early fall of 1913 public discussion of the proposed Federal Reserve legislation became very intense. The press had taken a deep interest in it and many associations of business men and bankers had sent delegations to Washington to present resolutions and to urge their views. After the bill had passed the House, the main efforts of those most interested in the measure were centered upon the members of the Senate Banking and Currency Committee; upon Mr. Glass, who, it was hoped, might still be persuaded to consent in the Conference Committee to a modification of some of the extreme features of the House Bill; and, finally, upon the President and Mr. McAdoo, who were expected to exercise an important influence in the ultimate formulation of the law.

The bill, at every stage of its development, represented a great triumph of the fundamental principles for which banking reformers had striven, namely, concentration and mobilization of reserves combined with an elastic note issue. Barring a few dissenting voices, the regional reserve bank idea met with approval, and the effort of the lawmakers to strengthen the influence of the government in the administration of the proposed System was generally endorsed. There was strong and fairly united opposition, however, to excessive decentralization by the creation of too large a number of Federal reserve banks, as well as to complete political control of the Board. Moreover, the issue of the Federal reserve banks' circulation as the obligation of the United States—a concession made to the extreme Bryan wing—was particularly objectionable to those representing independent business opinion.

While no doubt there were certain groups of bankers who, in voicing their objections and in formulating specific recommendations, were influenced by selfish considerations, an unbiased study of the record will demonstrate the fact that the suggestions made by most critics were prompted by a sincere desire to be helpful and constructive and to save a most promising law from being maimed by concessions to extreme political demands. An examination of the article mentioned in the preceding chapter, "The Owen-Glass Bill as Submitted to the Democratic Caucus," will show that this was the spirit in which that criticism was written. I have no doubt that, like many other contributions of the day, it would now be taken as an expression of the non-political thought as opposed to the political thought. Reprint of this article may be found in Volume Two of the present work. A summary of the article is presented in the following pages for those wishing to judge for themselves where the non-political thought was permitted to assert itself at the time of the enactment of the law, or later, and where it was defeated and left to continue knocking at the System's door, as it does to-day.[1]

The article began as follows:

> Now that we have before us the Owen-Glass Bill in the definite form in which it has been submitted to the Demo-

[1] Senator Glass has persistently used this article of mine as a justification for describing me as a tenacious disciple of the central bank gospel, as represented in Senator Aldrich's Plan, and as a "hostile critic" unalterably opposed to certain fundamental provisions of the Federal Reserve Bill. As early as 1915, he recorded the statement, "Mr. Warburg did not draft a sentence of the law" (Letter to *The World*, Willis, *The Federal Reserve System*, p. 542). In 1926, after referring to me as a "hostile critic" who "bombarded" the bill, he stated that all but one of my recommendations to the Senate Committee were "expunged from the bill in conference" by the House conferees. (*An Adventure in Constructive Finance*, p. 210.)

Dr. Willis likewise describes me as "a critic whose recommendations were not adopted" (Willis, *The Federal Reserve System*, p. 530); indeed, he goes so far as to say, "In fact, there were few portions of the bill which Mr. Warburg considered at all satisfactory" (*ibid.*, p. 432). In regard to these matters, the present chapter will enable the reader to draw his own conclusions.

cratic caucus, it may be interesting dispassionately to analyze it and to establish wherein it differs from and wherein it agrees in the main points with the bill of the Monetary Commission.

It is a source of great satisfaction to note that, as the Republican party had to outgrow and to abandon its old doctrine of "currency issued by national banks against government bonds," so the Democratic party had to relinquish its old heresies of the 16 to 1 silver standard and the guarantee of deposits. Both parties are now agreed that reform must provide for "a currency"—to use President Wilson's own words— "not rigid as now, but readily, elastically responsive to sound credit, the expanding and contracting credits of everyday transactions, and the normal ebb and flow of personal and corporate dealings."

There is a further and even more important progress. Both parties have now recognized that it is not the "currency" which is the exclusive or even the chief factor that needs reform, but that, indissolubly interwoven with this question is the problem of rendering available and efficient the now immobilized reserves of the country, and of mobilizing and modernizing the now illiquid American bills of exchange by creating a "discount market" and "bank acceptances." Both parties are thus in agreement as to the ends to be striven for; more than that, they are agreed even as to the technical means by which they must be attained. Accordingly, both plans provide for concentration of reserves, for the creation of an organization for the purpose of rediscounting commercial bills, for the substitution of an elastic note for the present national bank currency, and for a conversion of the 2 per cent government bonds into 3 per cent bonds.

The country is to be congratulated upon seeing these theories and principles clearly established; it remains the nation's duty conscientiously to watch that the aims now professed by both parties be carried into effect in the best possible way, and that they be not lost through ignorance, prejudice, or considerations of party policy. Where there is agreement as to the fundamentals, it should not be impossible to reach

an accord as to the means, provided they be honestly sought for.

Far from blindly endorsing the National Reserve Association Plan, I frankly admitted in that article that, in my opinion, Senator Aldrich had gone too far in his efforts to maintain the Republican doctrine of keeping the government out of business. But, while I approved of the effort of the Democratic lawmakers to strengthen governmental influence, I warned them against making the Federal Reserve Board a politically controlled body, stating as follows: "There can be no doubt but that, as drawn at present, with two Cabinet officers members of the Federal Reserve Board, and with the vast powers vested in the latter, the Owen-Glass Bill would bring about direct government management." It will be remembered that under the Owen-Glass Bill, as then drawn, two Cabinet officers and the Comptroller of the Currency were to constitute three of the proposed seven members of the Board, but that, in its final form, the Federal Reserve Act provided for only one Cabinet member on the Board.

In that article, I heartily endorsed a regional reserve bank plan, but uttered a warning against over-decentralization, expressing the belief that a maximum of six Federal reserve banks might prove successful in creating independent centers outside of New York in which discount markets might develop, whereas, if there were twelve reserve banks, New York would undoubtedly remain the sole money center. Moreover, I stated that a system of twelve autonomous reserve banks would prove a very unwieldy instrument for the Board to handle, and that it would offer great difficulties with regard to open-market operations, gold policies, and foreign relations. In subsequent chapters, we shall see how far these prophecies have proved true.

The article criticized the plan proposed in the Owen-Glass Bill for dealing with the national bank currency and set forth the following suggestions:

> . . . The entire national bank currency ought to be converted into elastic currency from the beginning. What do we gain by spreading this conversion of bonds and notes over twenty years? There is every argument for a prompt conversion.
>
> The present proposition is unsatisfactory for both the government and the banks. If we consider that within the last twenty years English, French, and German government bonds have gone down about 20 per cent, anybody would be a bold man who would dare to foretell at what price United States Government 3 per cent bonds will sell within the next twenty years. If the United States should embark upon any national enterprises entailing a material issue of bonds, the price certainly would go down. Should United States 3 per cent bonds sell below par, the national banks would, of course, not convert. The national bank note issue, in that case, would remain outstanding for twenty years, when the United States would have to sell a 3½ per cent or possibly 4 per cent issue to take the place of the old 2 per cent bonds.

History has entirely vindicated this criticism.

In addition, the following recommendation was made:

> Let the four or six Federal reserve banks jointly assume the national bank note issue and let them take over jointly, in proportion to their respective capitals, the 2 per cent government bonds. Let the government convert half of the amount so taken over into 3 per cent twenty-year bonds, the other half into one-year 3 per cent Treasury notes of the United States. As long as their charters last the Federal reserve banks would jointly bind themselves, whenever these one-year notes matured, to buy at par the same amount of new one-year 3 per cent Treasury notes.

This procedure was adopted, but, unfortunately, in a half-hearted way.

I protested vigorously against the plan of making Federal reserve notes obligations of the United States instead of making them obligations of the Federal reserve banks guaranteed by the United States. I did not join the numerous critics

who charged that the note issue as proposed involved the creation of "fiat money," but I feared that the theory of the issue of the currency by the government would strengthen the clamor for government control of the System. This fear was justified.

I approved of the principle followed in the Owen-Glass Bill of fixing a definite percentage of the deposits of member banks, as the measure of the reserve balances to be maintained by them with their Federal reserve banks, but I protested against the provision stipulating that a certain percentage of member-bank deposits should be immobilized in the vaults of member banks.

With the end in view of strengthening the Federal reserve banks and thereby strengthening the member banks themselves, the article stated:

> . . . The balances with the Federal reserve banks, that is, their cash holdings, ought to be increased as far as possible. The banks ought to hold only as large or as small an amount of actual cash as they actually need for their daily business, and all unnecessary cash should be deposited with the Federal reserve banks. Allowing for an ample supply of till money, but leaving the determination as to its size to the free judgment of the banks . . .
>
> The very object of the law should be to reduce to the smallest possible sum the amount of cash hoarded in the banks and to increase to the largest possible size the concentrated reserves in the Federal reserve banks. But it would be a mistake to attempt at this time to do more than to free and to consolidate the cash reserves, now wastefully impounded in the banks. It would be inadvisable to add to these vast sums substantial portions of the cash balances now kept with reserve agents as part of the legal reserves. These balances are now actively employed by the reserve city and central reserve city banks; if withdrawn from these banks and replaced by actual cash in vault, or by balances with the Federal reserve banks, the accommodation heretofore granted to the community by the

> reserve city and central reserve city banks will have to be provided by the Federal reserve banks . . .
>
> If the new law eliminates these bank balances (with reserve agents in central reserve and reserve cities—*Author*) as reserves, it ought to provide for a corresponding reduction of the reserve requirements . . .

The first part of this recommendation i. e., the plan to concentrate the largest possible amount of lawful money in the Federal reserve banks, and to end the obligatory decentralization and immobilization of reserve money in the vaults of the member banks, was not adopted at the time of the passage of the Federal Reserve Act. The Senate had been prevailed upon to embody in the bill a provision in keeping with my proposal, but Mr. Glass was bitterly opposed to it and the provision was expunged in conference. We shall see in a subsequent chapter how the plan urged by me ultimately had to be adopted. This all-important and hotly controverted question was covered in so many speeches delivered by me both before and during my service on the Federal Reserve Board that it is scarcely necessary to elaborate it here. The reader may be interested, however, in an abstract of a letter, dated December 5th, 1910, reprinted herein as Appendix Fifteen, containing a long argument addressed to Senator Aldrich, at a time when he, like Mr. Glass at a later date, was still unwilling to include in his bill a provision permitting member banks to count the notes of the National Reserve Association as reserve money. In the end, it will be remembered, the Aldrich Bill, as introduced in Congress, contained provisions allowing the notes to be freely exchanged for gold and to be counted as reserves.

The second part of the recommendation, to the effect that "required reserves" should be reduced if balances with reserve and central reserve agents were to be outlawed, was accepted by those in charge of the Federal Reserve Bill. A similar suggestion had been embodied in my analysis of the

Willis Digest of the second draft of the Glass Bill, addressed to Colonel House on April 22nd, 1913, wherein I coupled it with the suggestion that it might be made obligatory upon member banks to carry in the discount market a portion of the balances customarily kept in reserve and central reserve cities. Had some such plan of forcing reserve funds into the bill market been adopted, we might have succeeded in lessening the congestion of the country's liquid funds on the Stock Exchange of New York, which congestion, contrary to the avowed intention of the framers of the Act, has assumed larger and larger proportions.

A further article,[1] which was published simultaneously but separately, dealt with the question whether or not Federal reserve notes should be payable by the reserve banks "in gold" or "in gold or lawful money" when presented for payment at the Federal reserve banks. It is unnecessary here to repeat the argument on this question, inasmuch as in this respect I supported the plan as it was then proposed and as it stands to-day.

As stated before, there were many other contemporaneous essays and reports dealing with the proposed Federal Reserve System in a similar spirit and on substantially the same lines as my article. It is impossible for me to enumerate them or to analyze them in detail; it may be sufficient to cite one interesting illustration. Professor E. W. Kemmerer, now of Princeton University, as currency and banking expert to the National Progressive Service Headquarters, wrote on August 25th, 1913, a report on the Owen-Glass Bill containing a long list of proposed changes, among which we find the two following recommendations:

1. A reduction in the minimum number of regional banks from twelve to five or six.

[1] *The Owen-Glass Bill: Gold or Lawful Money, Note Issue, Government Bonds and Similar Questions*, New York; *Essays on Banking Reform in the United States*, Proceedings of the Academy of Political Science in the City of New York, Vol. IV, No. 4; pp. 604–612. See also Volume Two, p. 293.

2. Elimination of the section providing for the advisory council and insertion instead of authority for regional banks to elect two members of the Federal Reserve Board.[1]

It is worth noting that in the two suggestions cited above, Professor Kemmerer's mind, which I have reason to believe Mr. Glass regarded as that of a friend, and mine, which he classed as that of a "hostile critic," traveled along exactly the same lines. We were both, with others, exponents of the non-political thought.

On my way home from Europe, towards the middle of October, 1913, I prepared a technical *Memorandum* dealing specifically with the rediscounting sections of the Owen-Glass Bill and with the clauses concerning open-market operations, which, on account of their technical nature, had not been dealt with in my articles on that bill. (See Appendix Sixteen.)

One of the recommendations outlined in this memorandum concerned Section Fourteen of the Glass Bill and may be taken as an illustration of the kind of suggestions the memorandum contained. Section Fourteen is now Section Thirteen of the Federal Reserve Act. As passed by the House on September 18th, 1913, the first paragraph of that section read as follows:

> *Any Federal reserve bank* may receive from *any member bank* deposits of current funds—or checks and drafts upon solvent banks payable upon presentation. . . .[2]

The second paragraph read:

> Upon the endorsement of *any* member bank *any* Federal reserve bank may discount notes and bills of exchange arising out of commercial transactions. . . .[2]

For those who are familiar with the operations of the Reserve System, it is hardly necessary to explain the grotesqueness of these original provisions. These provisions would have permitted a member bank in Pensacola to deposit checks, or to

[1] For my recommendation in this regard see page 258 of Vol. II.

[2] The italics are mine—*Author.*

rediscount paper, in the Reserve Bank of San Francisco, or in any other of the "not less than twelve" reserve banks then proposed. It is quite impossible to envisage how, in such circumstances, it would have been practicable to organize a safe and properly functioning check-clearing system, or to exercise any supervisory control over the member banks of the System, or even over the reserve banks themselves. In my October memorandum, I urged that the first of these paragraphs be changed to read:

> Any Federal reserve bank may receive from any *of its* member banks and *from the United States* deposits of current funds.[1]

and that the second be altered as follows:

> Upon the endorsement of any of *its* member banks any Federal reserve bank may discount notes, drafts, and bills of exchange arising out of commercial transactions.[1]

Copies of this October memorandum were sent to Senator Weeks on October 30th, 1913, to Senator Owen, and to Secretary McAdoo on November 6th, 1913. Four days later, on November 10th, 1913, Senator Owen informed me, when we met on the train coming from Washington to New York, that my recommendation concerning these paragraphs of Section Fourteen, now Section Thirteen of the Federal Reserve Act, had been followed in the Senate draft of the bill. Shortly thereafter, a copy of the memorandum was received by Mr. Glass.

The bill, as finally agreed upon in conference and as enacted into law, accepted these changes as proposed by me. While the alterations in question comprised only a few words, their fundamental significance is evident. They restricted the rediscount operations of every reserve bank to its own district, and they permitted a member bank to have access to the clearing system solely through transactions with the reserve

[1] The italics are mine—*Author.*

bank of its own district—a procedure based upon a theory which has become the fundamental principle of the Reserve System as it stands to-day.

During the month of November, 1913, my personal relations with Mr. Glass began to gain in intimacy. Of this, the letter addressed to me by him on November 22nd, 1913, a reproduction of which appears on the next page, may serve as an illustration.

Two letters I wrote to Senator Glass in connection with the October memorandum mentioned above are given here for the light they may throw upon the problems in hand at that time.

New York, December 15th, 1913

DEAR MR. GLASS:

I send you herewith a copy of the memorandum which I worked out on the steamer some six weeks ago, when I returned to this country, and which I sent to Senator Owen. A good many points have since been covered, but as you said that you wanted to have this memorandum as soon as possible, upon the very untrue statement that your mind works slowly, I send it to you as it stands, not having the time to-day to rewrite it. On and after page 9, you will find some remarks about the collections. Will you please tell me, before I begin to redraw the Rediscount Clause, as you have asked me to do, what is your wish with respect to open-market operations. Are foreign bills to be purchased from non-member banks or not (provided bills bear three responsible signatures)?

Are American promissory notes which bear the endorsement of a member bank to be purchased in the open market by the Federal reserve bank from firms other than member banks? In other words: If L. & Co. offer a bill for sale to the Federal reserve bank, issued by Swift & Co. and endorsed by the Fourth National Bank of New York, should the Federal Reserve Bank of New York be permitted to buy such a bill from L. & Co.?

I take it that your understanding is that without the endorsement of the member bank such bill would not be

SIXTY-THIRD CONGRESS

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HOUSE OF REPRESENTATIVES,

COMMITTEE ON BANKING AND CURRENCY,

WASHINGTON.

November 22, 1913

Mr. Paul M. Warburg,
c/o Kuhn, Loeb & Co.,
New York City.

My dear Mr. Warburg:

I beg to acknowledge yours of November 21 with your letter to Senator Owen enclosed. I have read your letter with interest and will keep in mind the view that you present as to gold notes.

I wish I might talk with you again before very long on some of the details of the currency legislation. By the way, I have not yet received the printed copy of the Senate amendments with your proposed alterations. Did you leave it with the Secretary of Treasury for me?

With cordial regards,

Sincerely yours,

Carter Glass.

eligible as a rediscount for the Federal reserve bank, though the wording of the bill is not clear in this respect at present.

As to bank acceptances, my conception is that acceptances of member banks and of private banks may be purchased by the Federal reserve bank if they bear at least the signature of one member bank. In other words: If A. & Co. accepted a bill drawn against a shipment of tea from China, and if that bill were endorsed by the National City Bank, it would be eligible; if the National City Bank would be the acceptor and A. & Co. would be the endorser, should it be eligible?

Please give me your views in this respect, so as to be clear what you wish me to convey in redrawing this particular clause.

I enjoyed my interview with you very much indeed, and appreciated your courtesy in permitting me to counsel with you.

I am, with kindest regards,

Very sincerely yours,

PAUL M. WARBURG

P.S. I enclose copy of a letter from the President of the Comptoir National of Paris, a large French bank. You will see that they all agree. I saw Sir George Paish to-day—the London expert—he agrees absolutely that Federal reserve notes should be counted as reserves of member banks.

New York, December 18th, 1913

DEAR MR. GLASS:

I have not heard from you concerning the rediscount clause, and suppose that you are kept so busy by conferences that it is impossible for you to find the time to answer the questions which I put to you, and I therefore send you the clause as far as I could draw it without your reply.[1]

I have made a substantial change only in the first clause of Section Fourteen. I think the whole Section would be very much simplified if you would add, at the end of Section Three: "The local business at each Federal reserve bank point shall be organized and carried on in the same manner as

[1] For the clause as drawn, see Appendix Seventeen—*Author.*

that of the branches." This will permit you, in Section Fourteen, to speak of branches only, as in a great many cases including the Federal reserve bank, and you would thereby simplify this clause very much.

I have explained in the memorandum which I sent you the other day why it is necessary to strike out, at the end of Clause Four, the words: "The amount of acceptances so discounted shall at no time exceed one-half the capital stock and surplus of the bank for which the rediscounts are made."

In the fifth clause of Section Fourteen, I would suggest that after "or corporation" the words "rediscounted for any one bank" be stricken out. I believe the meaning of the law is that one single bank shall not grant any credit to any one individual or firm in excess of 10 per cent of its own capital and surplus. It is, however, conceivable that the Fourth National Bank, having given accommodation up to 10 per cent of its capital and surplus to Swift & Co. and having endorsed those bills to the Federal reserve bank might want to rediscount paper which it purchased from the First National Bank of Chicago, the latter having given accommodation to Swift & Co. and having endorsed the paper. The Fourth National Bank could then not rediscount it, because the signature of Swift & Co. would be on this paper, though it is guaranteed by the First National Bank, which I think is not what the law means. I think that the clause will read all right if the words "rediscounted for any one bank" would be eliminated.

In Section Fifteen, I have added in Clause (b): "Notes and obligations of States or Municipalities in Europe." This is important, and these obligations should not be subject to the clause "issued in anticipation of the collection of taxes, etc.," because it would not be possible to ascertain in Europe for what purposes these obligations would have been issued. Altogether, I think this restriction is a little technical and might be omitted.

For Clause (c), I have written a substitution, putting back almost the original clause, as the House Bill contained it, because I cannot understand why Senator Owen insists on striking out "foreign." It ought to be clear that this clause

deals exclusively with foreign exchange. It is necessary to have three signatures and not only two on long bills. This change I have also made in Clause (e). There should not be any agencies in Europe, if that practically means foreign branches of the Federal reserve banks, which would be entirely uncustomary and dangerous, because the supervision of those branches would be very difficult. Government banks, as a rule, take correspondents to act as their agents.

Section Seventeen, Clause Fifteen, beginning "Every Federal reserve bank shall receive on deposit from member banks or from Federal reserve banks checks, etc.," ought to be placed after Section Fourteen. I do not see what it has to do with note issues. The first sentence ought to be stricken out, because it is a repetition and not quite consistent.

I have not added a clause (because I do not know whether you approve of it) stating, as suggested to you the other day, that the Federal Reserve Board may promulgate from time to time rules and regulations, fixing a limit in excess of which member banks might be charged a higher than the published rate.

I congratulate you on the changes which, apparently, if the papers are correct, have been made in the bill, and am pleased to see that the gold reserve fund has been created, and that the tax for the gold reserve from 40 per cent downward has been put in. It would have been better yet if it had been possible to begin a little higher than 40 per cent.

I am now anxiously waiting for the next amendment, about which I spoke to you so often. If nothing else should be feasible, one might simply say that the Federal Reserve Board shall have power to permit, or to cause the establishment of four divisions—East, West, South, and North—within which the regional banks should be permitted to pool their earnings or to merge, but I sincerely hope you may be able to do better than that.

The bill is shaping up now splendidly, and it would be a great pity to miss that point.

Apologizing for writing you at such length, when your time is so valuable, I am,

Very sincerely yours,
PAUL M. WARBURG

I enclose a telegram just received from George M. Reynolds and letter from Credit Men's Association. How many more do you want and from whom?

Hon. Carter Glass,
Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D. C.

My October memorandum and letters referring thereto will illustrate, not only where recommendations of mine were followed, but also where they were disregarded. Sometimes the unwillingness to accept recommendations, which obviously were logical and sound, caused harm which it subsequently took years to undo. For instance, as stated in my letter to Mr. Glass of December 18th, 1913, the bill restricted the aggregate of bankers' acceptances to be endorsed by member banks in the open market to 50 per cent of their capital and surplus, while there was no limitation with regard to the amount they could endorse to reserve banks. The creation of a country-wide discount market was avowedly one of the main objects of the bill; here, then, was a provision which was bound to throttle the desired development of an open discount market. But those who were in charge of the bill persisted in leaving the defective clause unchanged. Some years later, this error in the original Act had to be remedied by amendment.

The meeting between Senator Owen and myself, to which reference has been made as having occurred on November 10th, 1913, took place in the course of a journey from Washington to New York. It afforded me an excellent opportunity personally to present to him at length and at leisure my arguments against some of the extreme doctrines he championed and to explain some of the intricacies of the banking questions involved. With regard to the latter, I found his mind most receptive, but

concerning his pet theories it was closed, and my attempt to win him away from those theories was a complete and absolute failure—a failure plainly shown by certain parts of the Act, as passed. After this meeting, however, Senator Owen kept in close touch with me. Drafts of the bill, as it advanced or retrogressed in the daily struggles of the Senate Banking and Currency Committee, came from him frequently with requests for advice and criticism.

Senator Owen, while adamant on the question of government note issue and on absolute government control of the Reserve Board, was less obdurate than Mr. Glass on the question of decentralization and was ready to sponsor a system containing a smaller number of reserve banks. Furthermore, he quickly grasped the importance of unimpeded gold concentration in the reserve banks and, as already stated, acceded to the insertion of a clause permitting Federal reserve notes, when in the vaults of member banks, to be counted as part of the "required reserves."

The Senate Committee on Banking and Currency was at that time widely divided within itself, and the number of members of both political parties in contact with me grew from day to day. I willingly served them to the best of my ability, indeed, I remember that on one occasion I was called to Washington in order to attempt—unfortunately without success—to bridge the differences existing between two of the leading Democratic senators.

When the bill passed the Senate, it provided for "not less than eight nor more than twelve" reserve banks. While this was distinct progress over the "not less than twelve" of the House of Representatives Bill, it did not go far enough to satisfy me. Moreover, it was still to be feared that the House Bill might prevail in this respect. In an excessive number of reserve banks I foresaw the gravest danger and, at every opportunity, I continued to argue for a smaller number, for, obviously, the greater the decentralization, the greater had to

be the powers vested in the connecting Board. To me, it was clear that, if there were twelve regional banks, no important money centers would develop outside of New York, and the excessive concentration of the country's free money on the Stock Exchange of New York would continue.

To all careful students it should have been clear that the larger the number of reserve banks, the greater would be the preponderance of New York, rather than the reverse. Even if the territory of the New York bank were cut down to the utmost, it would continue to overshadow the other districts, unless they should embrace very large geographic areas. With a large number of reserve banks, little or no personal and financial leadership could be expected from the smaller districts and, in the end, the Federal Reserve Bank of New York would become the pivot of the whole System. Such an outcome, while perhaps natural and from the point of view of efficiency not undesirable, might ultimately make the Reserve System an easy target for political attacks. The champions of a large number of reserve banks, nevertheless, continued to assume that the creation of large districts, few in number, would mean the sacrifice of local self-government. They failed to realize that, by a liberal and systematic development of branches, an intensive decentralization of credit might be accomplished and real local self-government brought about.

What I had in mind in all these discussions was a large number of branches which would serve as a foundation for a superimposed structure of reserve banks. Each of these branch offices was to have a board locally elected, and the board of the parent office of the larger district (the reserve bank) was to be selected from the membership of the branch boards. The directorates of these larger district banks would then have constituted composite and well-blended boards fully equipped to deal with broad questions of policy affecting the whole country. Thus I strove for a system composed of a small number of powerful units with diversified interests—

units which would offer a greater chance for the development of independent discount markets and, at the same time, leave the Reserve Board free to deal more effectively with the major problems of the System. In other words, I pleaded for a plan which, while securing the maximum decentralization of credit, would have enabled the Reserve Board, the general staff, to deal with whole armies, instead of being charged with the confusing and almost impossible task of directing from Washington a number of scattered regiments.

It still appears to me that my reasons for a small number of reserve banks were sound. Obviously, it is easier to drive a team of four horses than one of twelve. And if the twelve should consist of fast trotters, heavy truck horses, and mules, the task would require superhuman skill, particularly if there were eight drivers on the box.

My correspondence of those years shows to what extreme pains I went in my attempt to prevent members of Congress from committing what I then considered—and still consider to-day—a grave blunder. My files contain a large number of letters from European authorities. Included among them are opinions on regional decentralization from the heads of practically all the European central banks and from the presidents of the large European financial institutions to whom I had submitted the case. These letters, or abstracts of them, were sent to those in charge of the Federal Reserve Bill. I thought that, inasmuch as the point of view of a "Wall Street" man might be construed in Washington as "tainted," the arguments of these European bankers for a small number of banks might possibly have some weight with the chairmen of the Banking and Currency Committees of both Houses, and with other influential persons taking a hand in the formulation of the law.

After it became evident that there was no hope of getting the number of reserve banks reduced to less than eight, and that there was even danger that the law might provide for no less than twelve, I developed and submitted privately a plan

contemplating the creation of super-Federal-reserve districts. This plan provided for the coupling of some of the reserve banks so that each two reserve districts would constitute a super-Federal-reserve district. The Board would thus have dealt with four, five, or six groups, instead of dealing with from eight to twelve individual reserve banks. I hoped that this would enable discount markets to develop at the larger centers. This proposal, however, failed even though, as he afterwards stated, Senator Glass was not unfavorably impressed with it. In a letter I addressed to Mr. McAdoo on November 20th, 1913, I made an attempt to have the door kept ajar for the possibility of coupling together some of the districts at a later date. I urged him to have included in the Act a clause allowing for the linking together of reserve banks, two by two, upon their own initiative and request, supported by the recommendation of the Reserve Board, and upon the approval of the Secretary of the Treasury. Much to my distress, even this proposal, which seemed safeguarded beyond all hazards, proved unacceptable.[1]

What I did not realize in those days was that I was trying, by an appeal to reason, to prevail in an argument which had been closed by "politics."

During the weeks preceding the passage of the Federal Reserve Bill in the Senate, I was at various times invited by Secretary McAdoo to confer either with himself alone or with himself and others who were actively engaged in the preparation of the bill. Among the latter were Chairman Glass; Mr. John Skelton Williams, then Assistant Secretary of the Treasury; and Mr. Milton C. Elliot, later counsel of the Organization Committee and of the Reserve Board. At one of these conferences, at which I had severely criticized the plan of conversion of the 2 per cent government bonds, as proposed

[1] A very incomplete account of the final and futile effort on my part to have President Wilson's interest enlisted in this question is given in *The Intimate Papers of Colonel House*, Vol. I, p. 165.

in the draft of the bill, I was asked by Mr. McAdoo to submit a redraft of that section. Hurriedly, I then and there dictated and submitted to him the rough sketch of a plan to convert the 2 per cent bonds, one half into three per cent's, and the other half into one-year Treasury notes, renewable from year to year. The substance of this plan, which was closely akin to my previous recommendations concerning the conversion of the three per cent's, went into the Act, although weakened by certain modifications of which I did not approve.

After one of these conferences, I was greatly surprised by a question from Mr. Glass. The conference had been followed by a long and friendly visit with him at his hotel, in the course of which we had once more gone over some of the knotty problems involved in the formulation of the law. Suddenly, he asked me whether or not I would consider accepting an appointment as a member of the prospective Reserve Board. I took the question more or less as a joke or, at the most, as a compliment, and told him that I did not think the President would be at all likely to submit the name of a man associated with one of the leading Wall Street firms. When Mr. Glass urged the point, I finally answered that, while I still believed he was asking me an entirely hypothetical question, nevertheless, if the President should decide to propose my name in spite of all the opposition that might be offered to my appointment, it would be such an expression of the President's confidence that it would be very difficult for me to refuse. Beyond this, I did not take the matter very seriously. The question, however, gave me a great deal of satisfaction, because the mere fact that, in spite of the frequent divergence of our views, Mr. Glass should express the wish to see me on the Board, seemed to indicate a genuine appreciation on his part of my sincere interest in the cause of monetary reform.

During the last stages of the wrangle over the Federal Reserve Bill in the Senate, it often seemed as if stubborn resistance and procrastination might destroy the possibility of its

passage during the short session. But it was President Wilson's great merit that he did not relent in his pressure for action. Suddenly a slogan was invented to the effect that the Federal Reserve Bill was to be placed on the President's Christmas table as a gift from his devoted friends in the Democratic party. This appeal to sentiment, and the lure of the theatrical stage-effect involved, prevailed where stern reason had failed. A few days before Christmas, on December 19th, 1913, the Senate Bill passed as Senator Owen's "substitute for the House Bill," and was immediately taken up in conference.

In the course of the two months during which the Senate had struggled with the bill, and during which associations of business men and bankers had freely expressed themselves concerning it, a number of important improvements had been brought about. Weighing the advantages and disadvantages contained in the Senate and House Bills respectively, one is apt to reach the conclusion that, notwithstanding some of its gravely objectionable features, the Glass Bill had been superior to the Senate Bill as long as Mr. Glass had not surrendered to Senator Owen's demand for a Reserve Board entirely appointed by the President, and Federal reserve notes to be issued as obligations of the government. After the acceptance of these ominous provisions by the House, the Senate Bill, in its final, improved form, was, on the whole, the better instrument of the two. When, after the passage of the Senate Bill, committees from both Houses of Congress met in conference for the purpose of harmonizing the differences between the Senate and the House bills, it was generally hoped, therefore, that the desirable features of the Senate Bill would meet with the consent and approval of the House conferees, of whom Mr. Glass was the leader.

The Conference Report, however, proved a great disappointment. It is true that in certain respects the bill, as agreed upon in conference, showed some far-reaching improvements

over the House Bill. For example, the number of reserve banks was fixed in the Conference Report at "not less than eight nor more than twelve" (as against "not less than twelve" in the House Bill), and the number of *ex officio* members of the Board provided in the House Bill was reduced from three to two, and that of the appointive members increased from four to five. The conference furthermore struck out from the House Bill the following very objectionable clause:

> Of the four persons thus appointed, (*the Federal Reserve Board members*) one shall be designated by the President as manager and one as vice manager of the Federal Reserve Board. The manager of the Federal Reserve Board, *subject to the supervision of the Secretary of the Treasury* and Federal Reserve Board, shall be the active executive of the Federal Reserve Board,[1]

and accepted the Senate version, to wit:

> Of the . . . persons thus appointed, one shall be designated by the President as governor and one as vice governor of the Federal Reserve Board. *The governor of the Federal Reserve Board*, subject to its supervision, shall be the active executive officer.[1]

While to those who had hoped that the Senate provision providing for only one *ex officio* member and for six appointive members would prevail, the outcome was distressing. These changes, nevertheless, demonstrated progress of great significance in that they gave the Reserve Board at least a fighting chance for freedom from politics and governmental control.

The rediscount clause was also improved along the lines previously indicated, and the autonomy of the reserve banks was somewhat strengthened by changing subsection (d) of Section Fifteen of the Glass Bill into the form adopted by the Senate, to wit:

> Every Federal reserve bank shall have power: . . . (d) To establish from time to time, subject to review and deter-

[1] The italics are mine—*Author.*

> mination of the Federal Reserve Board, rates of discount to be charged by the Federal reserve bank for each class of paper.

In the Glass Bill, this section had read:

> Every Federal reserve bank shall have power . . . (d) To establish each week, *or as much oftener as required*, subject to review and determination of the Federal Reserve Board, a rate of discount to be charged by such Federal reserve bank for each class of paper.[1]

The earlier provision, in practical effect (as more fully explained in Addendum I), would have given the Board unchallengeable power to fix the rediscount rates.

On the other hand, the House conferees, fortunately, prevailed in eliminating the highly objectionable "insurance-of-deposits" clause contained in the Senate Bill. It was, however, a matter of deep concern that they succeeded in removing the clause in the Senate Bill permitting member banks to count Federal reserve notes in their vaults as "reserve money."

The Senate sections providing for domestic acceptances were also lost. At the same time, Mr. McAdoo and Mr. Williams injected some changes which were most regrettable. The modifications they succeeded in incorporating had the effect of strengthening the influence of the Secretary of the Treasury on the Reserve Board. The Glass Bill, as passed by the House, had provided that "the Comptroller of the Currency shall perform his duties under the general direction of the Secretary of the Treasury, *acting as chairman of the Federal Reserve Board*."[1] The last eight words were stricken out in conference.[2]

The Comptroller of the Currency was thus made entirely independent of the Reserve Board, a change which, as subsequent events have amply shown, has gravely hampered the

[1] The italics are mine—*Author*.

[2] The Senate had provided for a Board of seven members, including the Secretary of the Treasury *ex officio* and six members appointed by the President. The Comptroller, while placed "under the general directions of the Secretary of the Treasury," was *not* made a member of the Board.

development of the Federal Reserve System and has aggravated the Board's difficulties and weakened its authority. A further consequence of modifications made by the Conference Committee was that the Treasury retained the power of depositing its free funds with banks and trust companies, instead of being obliged to deposit such funds with the Reserve System. This latter change particularly distressed Mr. Glass, and he made a statement to that effect to the House when he submitted the Conference Report, which he characterized—perhaps somewhat oversanguinely—as being "in all fundamental respects the House currency bill." [1]

The Conference Report passed the Senate on December 23rd, 1913, at 2.30 P.M. The President signed the bill the same afternoon.

On the day the Federal Reserve Act was signed Secretary David F. Houston, a member of the Cabinet throughout the entire period of the Wilson Administration, made the following entry in his diary:

> The impossible has happened. To-day, Tuesday, December 23d, the currency measure became a law. The President approved it a few minutes after six o'clock in the afternoon. It was passed by a Congress dominated by the Democrats, two thirds of whom had been unsound on currency questions and a majority of whom can scarcely be said to have understood what the measure meant and would accomplish. The majority of the Republicans had also had an unenviable record on the currency. Bryan and several other members of the Cabinet had supported free silver, as had Vice President Marshall, the Speaker, Champ Clark, and many Democratic Senators. The measure itself was the result of the labours of many men, extending over a long period, but its passage at this time in its present form was due to Woodrow Wilson, ably supported by McAdoo, Glass, and a few others.[2]

[1] Glass, *op. cit.*, p. 336.

[2] Houston, David F. *Eight Years with Wilson's Cabinet, 1913 to 1920.* Doubleday, Page & Company, Garden City, 1926. Vol. I, p. 90.

This refreshingly unbiased account by a loyal Democrat gives us a just description of the origin of the Federal Reserve Act: it was, in truth, "the result of the labours of many men, extending over a long period." Individuals and associations in all parts of the country, business men, and economists, stirred up by the disaster of 1907, had struggled with the problem and, step by step, had worked their way towards a better understanding of the great principles that would have to underlie monetary reform. Had it not been for this pioneer work, the Democrats, when they came into power, would never have been able to bring about the banking legislation which some of them now claim as the exclusive achievement of their party.

The question of how far the text and substance of the Aldrich Bill benefited the "framers" of the Federal Reserve Act, when they began to formulate the provisions of that measure, will be more specifically dealt with in subsequent pages.[1]

But in view of the deprecating tone in which in their historical accounts both Senator Glass and Dr. Willis speak of the "labours of many men," referred to by Secretary Houston, this chapter ought not to close without the emphatic statement, by one who saw them at work, that they are entitled to the country's deepest and unreserved gratitude for the great service they rendered. It was due to the untiring efforts of these men that "the law was half made, and more than half made"—in Professor Munro's words—when Congress finally undertook its enactment. Our commonwealth is too dependent upon patriotic work done outside of Congress to permit so outstanding a contribution to go down into history, not only inadequately appraised, but actually misjudged and misconstrued. In earlier parts of this book reference has been made to the activities of the National Citizens' League during the Aldrich campaign. In order to complete the

[1] *See* Chapter VIII, "The Aldrich Bill and the Federal Reserve Act: A Juxtaposition of Texts"; Chapter IX, "An Analytical Comparison of the Aldrich Bill and the Federal Reserve Act based on the Juxtaposition of Texts shown in Chapter VIII"; Chapter X, "The Legatee of the Aldrich Bill."

record, without unduly lengthening this chapter, abstracts of an article "The Educational Campaign for Banking Reform" by Mr. A. D. Welton[1] have been reprinted in Appendix Eighteen. Mr. Welton was publicity director for the League throughout the greater part of its existence and his account may, therefore, be accepted as authentic. It is difficult, however, to reconcile it, and the facts presented in the course of this narrative, with Senator Glass's and Dr. Willis's accounts, of which the following from the pen of Mr. Glass may serve as an illustration:

> "An elastic currency," based on commercial assets, rather than "a rigid currency," based on the bonded indebtedness of the nation, was alleged to be the goal of the Indianapolis bill and, years later, of the Walker bank bill, the Fowler bill, the Williams bill, the Vreeland bill, the Aldrich bill, and the composite Vreeland-Aldrich bill. *The National Monetary Commission, and the Citizens' League organized to finance and otherwise promote the central bank plan projected by it, crammed this idiom to the point of satiety.*
>
> The phrase became so trite as once to overtax the patience of a profane colleague and provoke the expletive: "Oh, hell! Everybody wants that; but nobody seems to contrive a way to get it!"[2]

It is easy to see in how many respects this reference to the National Citizens' League is either incorrect or misleading.

The League, a thoroughly non-partisan body, had been organized for the purpose of promoting banking reform. It consistently refused to endorse the Aldrich Plan or any other plan, and it endorsed only principles. True enough, it endorsed most of the principles underlying the Aldrich Plan. When it became apparent that the Aldrich Bill could not pass,

[1] In special volume entitled *The Federal Reserve System—Its Purpose and Work*, Annals of the American Academy of Political and Social Science, Vol. XCIX, No. 188, January, 1922.

[2] Glass, *op. cit.*, p. 18. The italics are mine—*Author.*

the forces behind the League split. Some of its principal supporters, like the late Henry P. Davison, continued to favor the Aldrich Bill; others, like Mr. Frank A. Vanderlip, who, with Mr. Davison—as stated in an earlier chapter—had been among the most active promoters of the Aldrich Plan, came out with central bank plans of their own. The League itself had no substitute plan. Some of its most important members saw in the regional bank scheme a desirable variation of the Aldrich Plan, and one which, properly drawn up, would not violate the outstanding principles the League had endorsed, even though it might differ in many important details. In an attempt to be helpful in the working out of these details, these members, as has been stated, made individual suggestions for regional plans. At no time could it have been said that the League had a plan of its own or that, as a body, it was either endorsing or opposing the Aldrich Bill or the Federal Reserve Bill. Senator Glass, moreover, misses the mark entirely when he says that the League crammed to the point of satiety the idiom of "an elastic currency" based on commercial assets, rather than "a rigid currency" based on the bonded indebtedness of the nation.

The most important of all the principles endorsed by the League was the doctrine of the concentration and mobilization of reserves. So far as I know, this idea was never urged in the earlier campaigns and bills to which Senator Glass refers.[1] The outburst of Mr. Glass's profane colleague must, therefore, either have occurred before the campaign for banking reform began, or else the gentleman quoted must have been negligent in following the literature of the subject. To overcome the doubts and skepticism of men of the type represented by this

[1] It will be remembered, indeed, that the author of the Fowler Bill included in the Senator's recital, in spite of his undeniable merits in furthering currency association plans, has always been unrelenting in his bitter attacks upon both the National Reserve Association Bill and the Federal Reserve Act on account of the very elasticity of note issue and the concentration and mobilization of reserves embodied in both plans.

colleague of Mr. Glass's and to win the country over to the conviction that, indeed, it was possible "to contrive a way to get it," was the great merit and outstanding service of the educational campaign carried on during the years from 1908 to 1913.

Anybody unfamiliar with the facts would gain the impression from passages in Senator Glass's and Dr. Willis's books that bankers and business men presented a hostile and united front in resistance to the framers of the Federal Reserve Act. The opening paragraph of Chapter Fifteen of Mr. Glass's *An Adventure in Constructive Finance* will serve to illustrate this:

> While the federal reserve bill was pending, it was mercilessly condemned in detail by certain interests. Where there was any praise in these quarters, it was faint enough to damn. This hostile criticism reflected not alone the attitude of bankers, as the class which imagined that it was chiefly affected by the proposed readjustment; but it voiced the disapprobation of those business groups which are most readily impressed by banking thought. This was not surprising, since the phenomenon was and is of frequent recurrence. A very noteworthy exception was found among the National Association of Credit Men, whose members thought intelligently on the subject and understood the elements of the problem. These credit men were not only tolerant, but extremely helpful throughout the entire period of discussion.

In order to show how far such a picture fails to convey the truth; in order to demonstrate how genuine was the desire of business men to exert a helpful influence, some letters written by persons active in the movement in those days have been picked out from my files and reprinted as Appendix Nineteen. These letters, to which many others might be added, will not only enable the reader to understand the friendliness of the atmosphere in which they were written, but they will also show him that their writers, instead of being joint conspirators, were not infrequently at variance with one another on the

subject involved. Particular attention is drawn to letters written by Mr. J. H. Tregoe, Secretary-Treasurer of the National Association of Credit Men, (see Appendix Nineteen) whom Senator Glass in the paragraph just quoted describes as the "very noteworthy exception" and as not voicing "the misapprobation of those business groups which are most readily impressed by banking thought." Our readers will be amused to note from these letters that the National Association of Credit Men was distributing a leaflet, of which a copy was left with each member of the Glass Committee, which I myself had assisted them to formulate, and which, according to Mr. Tregoe, was "already creating thoughtful attention." A reproduction of this letter is found on the following page.

So far as my own experience went, I did not find the business groups, with which it became my good fortune to collaborate, greatly impressed by "banking thought," if by "banking thought" we are to understand "the attitude of bankers, as the class which imagined that it was chiefly affected by the proposed readjustment." As I knew them, the business groups were animated by the single purpose of securing the enactment of a sound currency reform and, in this matter, they were as free from "banking thought" as they were from "political thought." [1]

As to the bankers themselves, we have seen that there did not exist any united, crystallized "banking thought"; bankers, in groups and individually, held widely different views, both

[1] Extracts from a Report of the Banking and Currency Committee of the National Association of Credit Men (June 1912) and of the Committee's special letter to the membership have been added to the collection of letters assembled in Appendix Nineteen. These two documents have been included because they throw a highly instructive light upon the attitude of the National Association of Credit Men towards the plan of the Monetary Commission, the National Citizens' League and, incidentally, towards the American Bankers' Association. Perhaps I ought to add—in order to prevent any misunderstanding—that all these business men's associations, excepting, of course, the National Citizens' League, came to me entirely of their own accord.

NATIONAL ASSOCIATION OF CREDIT MEN

OFFICE OF THE SECRETARY-TREASURER

41 PARK ROW

NEW YORK Jan. 7, 1913.

Mr. Paul M. Warburg
Kuhn, Loeb & Co.,
52 William St.,
New York, N. Y.

Dear Mr. Warburg:-

Upon the suggestion of Mr. D. G. Endy of Philadelphia, Chairman of our National Committee on Banking and Currency, I am pleased to hand you enclosed five copies of our "Banking and Currency Leaflet No.1." This is the leaflet which you so kindly assisted us to definitely formulate, and it is already creating thoughtful attention.

We hope very soon to have it in the hands of the very largest number of our commercial men throughout the country, and if you can use a few additional copies to advantage I shall be delighted to supply them.

Sincerely yours,

Secretary-Treasurer.

as to objects and methods. The belief seems warranted that some day the historian, comparing the evidence of facts with the accounts given by the "framers of the Act," will reach the conclusion that there was less hostility surrounding them than they seem to have surmised and more friendly support than they were able or willing to realize.

CHAPTER VII

THE FEDERAL RESERVE ACT IN EVOLUTION

(1914–1917)

THE passage of the Federal Reserve Act was an achievement of the first order. The new law, in its essentials, was sound and marked progress beyond any expectation, even though some grave "sins of omission and commission" in its enactment remained a source of deep disappointment to those who, for years, had so earnestly striven to secure for the United States a banking system of the highest possible order. What my own feelings were in the matter may be gathered from a letter I wrote to Mr. Glass on December 23rd, 1913:

New York, N. Y., December 23rd, 1913

DEAR MR. GLASS:

Permit me to congratulate you upon having successfully brought to an end the very onerous task of perfecting the currency law, and steering it through the many cliffs.

While my heart bleeds at many things that went into the bill, and many things that were left out, I rejoice at the many good features that, after all, the law will contain. There cannot be any doubt but that the perfection of this legislation means a new era in the history of banking in the United States. The fundamental thoughts, for the victory of which some of us have worked for so many years, have won out. That is to say, from now on we shall witness the gradual elimination of the bond-secured currency, of scattered reserves, of immobilized commercial paper, and of pyramiding of call loans on the stock exchange. Where we differ it is in most cases a question of degree. Whether concentration has gone far enough with eight Federal reserve banks, whether reserves will be sufficiently consolidated by lodging a portion in the

hands of the member banks, and by not permitting the notes to be counted as reserves, whether $25,000,000 annually is a large enough amount for reducing the inelastic national bank currency, whether ninety or hundred and eighty days is the right maturity for paper to be rediscounted, all these are questions not of principle, but, as stated, of degree.

As long as this legislation was a question for discussion, it was incumbent upon all of us to offer the freest criticism, and to try to be helpful within the limits of our abilities. Now that, for the time being at least, the discussion is closed, and the law will go into effect, there remains only one thing for us to do, and that is for each of us to do the best he can to give it the fairest and fullest test. If, after a few years of actual experience, it should be shown that the business community was wrong in its suggestions and in its apprehensions, we shall be satisfied; if it should be shown that we were right, I believe that the country at large and its representatives at Washington will then be perfectly willing to amend the law. By that time a great many things which to-day are questions of theory will have become hard facts, and everybody will be able to judge from actual experience. In this, I am sure, we both feel alike, because from the various talks that it was my privilege of having with you, I am more than confident that, if you could have had things entirely your own way, the law would look different in many respects. It is only natural that, in a matter where so many minds had to agree, concessions and compromises were necessary, and I suppose we shall have to be satisfied with having been able to make so substantial a step in advance. I sincerely hope, however, that a conservative Federal Reserve Board will see to it that the instrument now created will not be overtaxed. As it has been enacted, the law will provide for an emergency organization, which will be safe, if conservatively managed, and which will, very gradually only, lead toward substantial fluidity of credit by the creation of discount markets.

It is earnestly to be hoped that, if it should prove impossible to reach this latter aim, in the immediate future, the future

board will not overheat the boilers up to a danger point by trying to make this craft perform duties which now may be beyond its power, but rather, after a fair and conservative test, do the necessary work of perfecting the construction.

Meanwhile you are entitled to the thanks of the nation for the hard, conscientious, and able work that you have done, and personally I want to add my sincere appreciation for having been permitted to counsel with you so frankly and frequently.

With assurances of highest esteem, and with best wishes, I beg to remain,

Yours faithfully,
PAUL M. WARBURG

Hon. Carter Glass,
Chairman, The Committee on Banking and Currency,
House of Representatives,
Washington, D. C.

Letters in similar vein were sent to Secretary McAdoo and Colonel House. Their replies are given below:

THE SECRETARY OF THE TREASURY,
WASHINGTON

December 29th, 1913

DEAR MR. WARBURG:

Let me thank you heartily for your kind letter of the 23rd of December and for the fine spirit it displays. I greatly appreciated the intelligent interest and suggestions you made concerning the new currency law, and I hope that the measure as enacted may prove adequate for the purpose. Where there exists, as in this case, such an immense variety of conflicting opinion it would be expecting too much to believe that a perfect measure would be possible at the outset. I am quite sure that any needed changes which time and experience may prove to be necessary, will be secured.

The task ahead of me and the Organization Committee is a great one, but I shall tackle it with all the enthusiasm and power that I possess and shall do my utmost, with the other members of the committee, to organize the new system from

the highest standpoint of patriotism and good of our country.

Believe me with best wishes for the New Year,

Sincerely yours,
WM. G. MCADOO

HOUSE OF REPRESENTATIVES

COMMITTEE ON BANKING AND CURRENCY

Washington, December 24, 1913.

DEAR MR. WARBURG:

Permit me to acknowledge your kind letter of December 23rd and to express my very great appreciation of your congratulations. I desire also to thank you for the aid and encouragement which, from time to time, you so cheerfully extended the Banking and Currency Committee of the House and, especially, to express my personal indebtedness for the assistance you have given me. If the country could know the true story of the struggle here it would realize that the public interest has been as well served by expunging the things which have been excluded from the Currency act as by those which have been included.

Without meaning to convey the idea that I have any knowledge of what may happen, I take leave to suggest that you might well give serious consideration to the rather personal question that I put to you in my room at the Raleigh when you were last here.

With best wishes of the season, I am,

Sincerely yours,
CARTER GLASS

DEAR MR. WARBURG:

Thank you for thinking of me and for saying such generous things. It is you, I think, that just now deserves the gratitude

of your countrymen, and some day I shall tell them when and how you served them.

Sincerely yours,
E. M. House

New Year's Day
1914.

These letters are of considerable interest, because they are acknowledgements of a frank statement on my part that the Federal Reserve Act as passed should not be considered as a finality, and that actual experience in its operation would prove the need of important modifications or amplifications. Secretary McAdoo, in his letter, freely admits the possible need of such amendments. Mr. Glass, notwithstanding the notice thus served by me, invites me once more to "give serious consideration to the rather personal question that I put to you in my room at the Raleigh," meaning the possibility of my appointment to membership on the Reserve Board. Mr. Glass's reiteration of the suggestion perturbed me a good deal. It faced me with the question whether, if such a call were to come, it would be my duty to accept it in spite of my strong conviction that, as written, the Federal Reserve Act, although of great merit, was bound to prove inadequate. The more I pondered, the clearer it became to me that success or failure would depend entirely upon the sagacity and courage with which the men first called to the helm should perform their task.

Under the provisions of the Act, as passed, the Reserve System might have been administered on either of two general lines of procedure. The first, and perhaps the more obvious, would attempt to develop eight or twelve individual central banks, entirely independent of one another and kept as far apart as possible so that the only connecting link between them would be the Reserve Board. The Board, with the powers of a governmental body, would then administer the System by rigid bureaucratic rules and ordinances,

treating the Act as perfect and as a finality and striving to force business to accommodate itself to it. Under such procedure, failure would be inevitable.

The other line of procedure would aim to bring about as much cohesion between the reserve banks as the law permitted and attempt to increase the prestige of these banks as much as possible so that, instead of merely being obedient tools of the Board, they would assume positions of leadership in their own communities. This course would involve the exceedingly difficult task of formulating rules and regulations which, while clearly defining and codifying the best existing banking practices, would still be elastic enough to allow those in charge of the management of the reserve banks to use their discretion in meeting the varying needs of the East, the West, the North, and the South, and, likewise, the widely differing requirements of the large cities with their huge institutions and the small villages with their miniature "banklets." A Board adopting this procedure would, moreover, have to recognize that the Act, as passed, was far from perfect and that one of the Board's foremost duties would be to recommend to Congress those changes which a fair and sympathetic practical test would indicate as essential for a sound development of the System. To accept the Act as perfect and as final would be to offer the highest compliment to its authors and to the government; to administer it uncritically and in a bureaucratic spirit would, moreover, be the easiest and safest path for individual members of the Board to pursue. It would mean, however, that the Reserve System would remain dwarfed; that, in peace, the country would be deprived of the full benefits of the System's free and untrammeled growth; and that, in times of stress, the System would show its inadequacies, with fatal consequences.

Would the new Board have vision and courage enough to choose the thorny, second path leading to bitter struggles in the beginning, but opening a route to unparalleled success in the

end? Some of the disasters which might occur if the Board should administer the law uncritically were staggering. If, for instance, the Board should consider it obligatory, instead of merely permissive, to charge interest when "advancing" Federal reserve notes to the reserve banks, the free exchange of Federal reserve notes for gold—and with that the concentration of the country's gold in the reserve banks—would be doomed. If, giving way to political pressure, the Board should permit the reserve banks to establish an immediate credit par check clearing plan, without any charge for interest, the back of the Reserve System might be broken right from the beginning, while inflation on the grandest scale might ensue. There were also the additional dangers that reserve banks might have their strength dissipated by being forced prematurely into earning dividends, and that an attempt would be made to coerce state banks and trust companies to join the System, instead of making it attractive enough for them to enter it of their own free will.

Considerations such as these weighed heavily on my mind. When finally, in the last week of April, Colonel House showed me the list of the men the President had selected for membership on the first Federal Reserve Board and asked me whether I would be willing to accept the appointment, I had become convinced that no one with the interests of the country genuinely at heart would be justified in refusing to give the best that was in him to the perfection of the great work about to be undertaken. Colonel House told me that ex-Secretary of State Richard Olney was to be invited to serve as the first governor of the Board. I told Colonel House that the list of my future colleagues (none of whom I knew) was perfectly satisfactory to me, provided he could assure me that they would all undertake their duties with open minds, untrammeled by preconceived notions or political obligations. If that were the case, I would be prepared to undertake the venture and I was convinced that, working as an ordinary

THE WHITE HOUSE
WASHINGTON

April 30, 1914

My dear Mr. Warburg:

After several months of very careful thought on the subject and a sincere attempt to canvass the whole country for material of the kind that the whole country would approve, I have come to some very definite conclusions with regard to the make-up of the Federal Reserve Board. I am asking the Hon. Richard Olney to take the governorship and (for fear he would at his age decline a longer appointment) the two-year term on the Board, and I am writing to ask if you would not be willing to do the country the great service of accepting the four-year appointment. I feel that your counsel would be invaluable to the Board and I sincerely hope that you may see your way to making the sacrifices necessary to accept.

Cordially and sincerely yours,

Woodrow Wilson

Mr. Paul M. Warburg,
New York City

member of the Board, I would be in the most advantageous position for rendering the best service of which I was capable. Colonel House stated that he could give me that assurance. Soon after President Wilson wrote to me, asking me to become a member of the Federal Reserve Board, and I accepted his invitation by return of mail and without any reservation. The President's letter, a reproduction of which appears on the preceding page, and my reply follow.

THE WHITE HOUSE

WASHINGTON

April 30, 1914

MY DEAR MR. WARBURG:

After several months of very careful thought on the subject and a sincere attempt to canvass the whole country for material of the kind that the whole country would approve, I have come to some very definite conclusions with regard to the make-up of the Federal Reserve Board. I am asking the Hon. Richard Olney to take the governorship and (for fear he would at his age decline a longer appointment) the two-year term on the Board, and I am writing to ask if you would not be willing to do the country the great service of accepting the four-year appointment. I feel that your counsel would be invaluable to the Board and I sincerely hope that you may see your way to making the sacrifices necessary to accept.

Cordially and sincerely yours,
WOODROW WILSON

May 1st, 1914

DEAR MR. PRESIDENT:

Permit me to acknowledge receipt of your letter of April 30th, and to express to you my profound appreciation for the great confidence that you have shown me by inviting me to serve on The Federal Reserve Board for a term of four years.

Whether any personal sacrifices are involved, or not, it is a rare privilege to be offered so great an opportunity for public

service, and I accept the high honor which you confer upon me, with the sincere hope that my services may justify your confidence in me.

I beg to remain, dear Mr. President, with assurances of highest esteem,

Very faithfully yours,

PAUL M. WARBURG

To the President,
The White House,
Washington, D. C.

THE WHITE HOUSE

WASHINGTON

May 4, 1914

MY DEAR MR. WARBURG:

Your letter of May first consenting that I should nominate you to the Senate as one of the Board of Federal Reserve does you great credit and affords me the deepest gratification. I thank you for it most sincerely and shall look forward with genuine pleasure to being associated with you here.

Cordially and sincerely yours,

WOODROW WILSON

The membership of the first Board, as submitted to the Senate for confirmation, differed from the first tentative list of appointees drawn up by President Wilson. Mr. Olney declined the position of governor on account of his advanced age and Mr. Charles S. Hamlin, at that time Assistant Secretary of the Treasury under Mr. McAdoo, was finally chosen by President Wilson in his stead. Mr. W. D. Simmons, of St. Louis, and Mr. Harry A. Wheeler, of Chicago, having declined to serve, the President named Mr. Thomas D. Jones,

a prominent lawyer of Chicago. The other members were chosen from the President's original list.

If I were writing "memoirs," this would be the place in which to record the incidents of the struggle that ensued in regard to my confirmation by the Senate. I had informed the President and Secretary McAdoo that I would not object to appearing before the Senate Committee if all the prospective members of the Board were called for examination. But when, on July 2nd, 1914, Mr. Hamlin, Mr. Harding, and Mr. Miller were favorably reported, while Mr. Thomas D. Jones and myself were singled out for appearance before the Senate Committee, I refused to respond to the Senate's invitation, stating that I was not a "candidate for office" and that, while the Senate had the right to refuse my confirmation, it was my privilege to refuse to submit to what I considered a humiliating procedure.

The deadlock continued for four weeks during which the President urged me to give in, while I urged him to withdraw my name. Much to my mortification, the controversy became one of the main topics of the newspapers. In the main, the press and public opinion strongly supported my stand. For the purpose of this narrative, it is sufficient to relate that, when the Great War broke out, I waived my own feelings and, on August 1st and August 3rd, 1914, appeared before the Committee. After having been grilled by Senator Bristow of Kansas for a day and a half, I was promptly confirmed and took office on August 10th, 1914. (For the hearings before the Senate Committee on Banking and Currency see the confidential report printed by the Government Printing Office, dated August 5th, 1914).

Upon its organization, the first Reserve Board was finally constituted as follows:

William G. McAdoo, Secretary of the Treasury, Chairman *ex officio*

John Skelton Williams, Comptroller of the Currency, *ex officio*

Charles S. Hamlin, Governor	(2 years)
Frederic A. Delano, Vice Governor	(6 years)
Paul M. Warburg	(4 years)
W. P. G. Harding	(8 years)
A. C. Miller	(10 years)

At the first meetings of the Reserve Board, it became clear that a majority of the members were bent on approaching their problem with a strong inclination towards a bureaucratic policy of administration which would freely employ the ruler and, if necessary, use it as a "big stick." On the other hand, the minority, to which I belonged, strongly advocated the alternative policy. Fortunately, the minority point of view gradually asserted itself and, by a narrow margin, eventually won out. It finally became the prevailing policy of the Board, even though there remained at all times a strong faction which clung to bureaucratic doctrines and which, every now and then, succeeded in having its own way.

The impelling needs of the situation soon forced the Board to consider the advisability of suggesting amendments to the Federal Reserve Act. Some of these took form at a fairly early date, but others were debated for years before they were ultimately submitted as recommendations to Congress. It is not possible for me to write here a full history of the amendments which have been made down to the present time; I shall merely indicate the important modifications effected in the first four years, administratively or through changes in the Act, which have proved to be of decisive moment in perfecting the Reserve System, and giving it its present form and strength.

Senator Glass waxes quite eloquent when he claims credit for the great achievements of the Reserve System and praises the unequalled strength it finally developed. He writes:

> If there was a trace of exaggeration in the estimate of that seasoned English economist who declared the federal reserve

system "worth to the commerce of America more than three Panama Canals," nevertheless, it must be conceded that, in the crucial test of a world war, it was bound to be more indispensable to civilization than three times three Panama Canals.

This merely means that I agree with the considered judgment of those eminent bankers of this and other lands who have said that the World War could not have been financed but for the Federal Reserve Act. And if not financed, of course, it could not, except at infinitely greater sacrifice, have been won by the United States and associated nations. Thus, in a final analysis, the real value of this one achievement of Wilson's administration might be fairly appraised by simply leaving to the human contemplation what further slaughter and destruction would have ensued or what would be our situation to-day had we lost the war with the Central European Powers![1]

It is necessary, however, to remember that, without the amendments later enacted, the Federal Reserve System could never have accumulated its present imposing gold strength and reserve power. If, to-day, countries in all parts of the world look to the Reserve System as the model to be copied; if Australia contemplates it as such, and if British leaders recommend it as embodying the principles desirable for "good old England," these people have not in mind the dwarfed and limping system originally sanctioned by Congress, but the System as it stands to-day, freed from its original deadly straitjacket. Senator Glass cannot well be permitted, on the one hand, to arrogate to himself the credit for the System in its present form, and, on the other, to point with pride to the fact that, at the time of the writing of the Act, he declined the very proposals which Congress had to adopt later in order to insure for the Reserve System the great success it subsequently achieved.

Possibly the most impressive illustration of amendments which had a decisive influence in remoulding and perfecting the Reserve System is the metamorphosis of the reserve and note-

[1] Glass, *ibid.*, p. 2.

issue provisions. It is due to the changes in these provisions that reserve banks are able to-day freely to substitute their own notes for the gold and gold certificates previously carried in the pockets of the people or tied up in the tills of the member banks, and it is to these changes that the Reserve System of to-day owes its unparalleled gold strength. It took almost three years of patient and unremitting effort to accomplish these drastic but all-important changes. Powerful and determined resistance, inside and outside the Board, had to be broken down inch by inch, and the fight might have been lost had not the keen realization of the dangerous insufficiency of the System exercised its constant urge and stimulated the inventive genius and determination of those struggling for the financial safety of the country.

In the early stages, when there was no hope for remedial action by Congress, relief was sought in a roundabout manner by the creation of a reserve fund of gold which would be readily available in case of need. This was accomplished by devising a plan to pile up in the hands of the Federal reserve agents some hundreds of millions of dollars of gold or gold notes, which, however, as a technical compliance with the law, had to be held as having redeemed outstanding Federal reserve notes. Neither the gold so held nor the notes issued against it were included as assets or liabilities of the Federal reserve banks. The operation in substance amounted to the substitution of these notes for gold and gold certificates in circulation. The plan, in brief, was to allow the issuance of notes backed by a 100 per cent gold cover instead of by 40 per cent gold and 100 per cent commercial paper. This enabled the reserve banks, in case of heavy rediscount demands, to substitute discounted paper and to use the 60 per cent gold so withdrawn as a reserve for further note issues. It was a very cumbersome, indirect, and unsatisfactory method, but it had to be followed in order to bring the procedure within the formalities of the law. Moreover, it subjected the Board to the unjustified but per-

sistent charge that it was permitting or abetting a course of conduct unauthorized by the Act.

After a prolonged period of patient experimentation, the Board requested Congress to pass an amendment authorizing, in plain words, the direct substitution of Federal reserve circulation for gold and gold certificates and providing for the frank inclusion of such additional gold in the general assets of the reserve banks (instead of carrying it in the banks' balance sheets against "notes redeemed"). The Board, furthermore, asked for the removal of the ridiculous provision which stipulated that, for every dollar of Federal reserve circulation, there must be set aside one dollar in commercial paper and, in addition, no less than forty cents in gold. The type of work done in those days in the direction of removing some of the harmful shackles placed upon the System, and of strengthening its base, is well illustrated by a section of a memorandum which I submitted to the Board at its session on December 3rd, 1915, reprinted as Appendix Twenty, and by a letter of mine to Mr. Glass, dated February 29th, 1916, reprinted as Appendix Twenty-One. A few quotations from addresses I was invited to deliver in those years may likewise serve to throw further light upon the efforts made at that time to overcome the resistance of those hesitating to follow, or offering determined opposition to our plans and views.[1] The following is a quotation from my address to the bankers of Minneapolis and St. Paul:

> It is to your interest to see the Federal reserve banks as strong as they possibly can be. It staggers the imagination to think what the future may have in store for the development of American banking. With Europe's foremost financial powers limited to their own field, with the United States turned into a creditor nation of all the world, the boundaries

[1] Cf. speeches made at Charlotte, North Carolina, on November 23rd, 1915; St. Paul, Minnesota, on October 22nd, 1915; Atlantic City, on June 9th, 1916; and Kansas City, on September 29th, 1916; all of which may be found in Volume Two.

> of the field that lies open for us are determined only by our own power of safe expansion. The scope of our banking facilities will ultimately be limited by the amount of gold that we can muster as the foundation of our banking and credit structure. Gold that is carried in the pockets of the people, gold that accumulates as excess reserves in the member banks' vaults, does not afford the maximum service that the country is entitled to expect. Excess balances and idle gold should accumulate in the Federal reserve banks. They should not control $300,000,000 of gold, as they do now, or $450,000,000 as they will after another year, but they should control a billion or two of gold. The stronger the Federal reserve banks become, the stronger will be the country and the greater its chance to fulfill with safety and efficiency the functions of a world banker. The basis of this development must be confidence. Unless the member banks are profoundly convinced that their balances are as safe with the Federal reserve banks as they are in their own vaults—besides being more useful and efficient there—and unless they are convinced that the Federal reserve banks will not abuse their vast resources for inflation of credit or for the purpose of aggressively competing with the member banks, the full growth of the System and with that the full growth of American banking, cannot be attained.

In the same vein is a quotation from an address delivered at Kansas City before the American Bankers' Association:

> Does it not appear ridiculous that a country owning over $2,500,000,000 of gold should not be able to mobilize a larger free gold reserve than $200,000,000—or $300,000,000—particularly when it is apparent that its future financial and economic growth will depend upon the extent of the "preparedness" that it can provide in this respect?

If Mr. Glass felt obliged to combat the theories and views expressed in the speeches just quoted, he was not alone in his opposition; he found strong support among prominent economists and editorial writers. As an illustration, some

"leaders" may be cited which appeared at that time in *The Commercial and Financial Chronicle*. These are reprinted herein as Appendix Twenty-Two and Appendix Twenty-Three, respectively. Indeed, a member of the Board who shared Mr. Glass's views took issue with me in public concerning the opinions I had expressed upon the vexed problem of gold concentration in the above mentioned Kansas City address. This clash between Board members was freely discussed by the Press. Hence it seemed wiser not to prolong a public controversy. An unpublished reply to this colleague of mine, reprinted as Appendix Twenty-Four, may, however, prove of interest, as it offers an impressive illustration of the earnestness and persistence with which honest differences of opinion were fought out between us. It is gratifying to record, however, that bitter debates in the board room never affected the personal relations between members. A feeling of warm friendship developed in spite of, or possibly even by reason of, these differences of opinion, and while delays were often caused by these controversies, progress was all the more enduring when it finally was secured.

The Board's proposed amendments made satisfactory progress in the Senate, but the House—under Mr. Glass's influence succeeded in emasculating the proposed modification of the section covering the note issue. The Conference Report of August 23rd, 1916, contained the following significant paragraph:[1]

> The Senate receded from its amendment of section 16 of the Federal Reserve Act which would have explicitly authorized and encouraged Federal reserve banks to issue Federal reserve notes based upon gold or gold certificates.

It is true that the amendment as passed on September 7th, 1916, provided, among other things, for the utilization of acceptances and bills bought in the open market as collateral

[1] *Willis*, p. 1261.

for Federal reserve notes, and that it gave power to the Board to permit member banks "to carry in the Federal reserve banks any portion of their reserves now required to be held in their own vaults." This denoted some progress at least in the right direction.

As for myself, I continued, both inside the Board and out, to stress the imperative need for the mobilization of the country's gold.

The following is a quotation from an address entitled "Government and Business," delivered by me in Chicago on April 7th, 1917, after we had entered the War:

> . . . About our power to take care of ourselves there can be no doubt. But in view of the unparalleled demands that may be made upon us both during the War and after the conclusion of peace—demands which it may be our highest national interest and duty to satisfy—we should not neglect to perfect our financial machinery to such a degree as to give it the greatest possible strength.
>
> For this reason the Federal Reserve Board has again recommended to Congress amendments having for their object a still further concentration in the Federal reserve banks of gold now held in scattered bank reserves and a more liberal substitution of Federal reserve notes for our present rigid 100 per cent gold certificate circulation.
>
> One billion dollars, one-third of the gold holdings of the United States, is at present "unaccounted for;" you and I carry it in our pockets, it is in the tills of the baker, the grocer, and the dry goods store. We all would just as lief take Federal reserve notes—our government's absolute obligations secured at present by practically 100 per cent of gold and all the assets of the Federal reserve banks. It is as apparent that it would increase our strength enormously if we could add to our organized reserves a substantial portion of this wasted gold, as it is obvious that it would be nothing short of a crime wilfully to withhold from our country at this time so vital an addition to its power of offense and defense.

> Unfortunately, in the general tie-up of all legislative work at the end of the preceding session, Congress was unable to pass the desired legislation. It is most essential for the best interests of the country that prompt action be taken by the present Congress and it is most desirable that public opinion assist the committees on banking and currency in securing early and favorable consideration of these amendments, which will enable us promptly to complete our financial mobilization. . . .

These amendments relating to gold reserves and note issue were prepared before the United States entered the World War. By presenting them and urging their adoption, the Reserve Board had only done its duty; it had looked ahead and had endeavored to place the United States in a position of adequate financial preparedness. Mr. Glass's resistance to the Board's plans, however, could not be broken down. Even during the critical months immediately preceding and following our declaration of war, he stubbornly held to his views. Secretary McAdoo, on the other hand, after the problem had been explained to him, quickly understood the weakness of the System and the dangerous conditions which might develop. Wholeheartedly and with his usual energy, he placed himself on the side of the amendments[1]; in fact, he helped to consolidate the Reserve Board's stand in the matter and urged Mr. Glass, in consideration of the impelling needs of the situation, to consent to the proposed changes. But Mr. Glass remained adamant. The problem became so important that President Wilson, upon the Board's insistence and at Mr. McAdoo's request, entreated Mr. Glass to coöperate with us. Still the latter persisted in his resistance, and the only concession he reluctantly would make was, temporarily, to remove himself from the Congressional field of battle. He agreed that, if, during his absence, we should be able to secure the coveted

[1] A record of these amendments may be found in the 1916 and 1917 numbers of the Federal Reserve Bulletin.

legislation, he would not obstruct it. A difficult task then devolved upon me, leading to an intensely interesting situation.

In Mr. Glass's absence, Mr. Michael Phelan, of Boston, became the acting Chairman of the House Banking and Currency Committee. I promptly made an appointment with him and shortly afterwards we walked together to the Treasury Building. On one side of the meeting-room of the Reserve Board, a huge blackboard had been placed. This blackboard extended from one end of the room to the other and showed in colored lines the amount of our investments and our gold holdings. With the aid of this diagram, it was easy to demonstrate how quickly added demands would wipe out our free gold reserves. I had never met Mr. Phelan before; but, during our long talk in front of this graph, I was impressed with his earnestness and courage. It was no easy matter for him to assume the responsibility of leadership in securing legislation to which, it was well known, the chairman of the Banking and Currency Committee, whose name carried so much authority, was unalterably opposed. At the end of our discussion, Mr. Phelan said he wished to take a few days in which to think the matter over. A little later he showed his mettle by stating that he had become convinced of the fact that there was an imperative need for the new legislation and that he was willing to do his share in bringing it about.

Mr. Edmund D. Platt, the present Vice Governor of the Federal Reserve Board, was then the ranking Republican on the Banking and Currency Committee. I invited him to walk over to the Treasury with me so that I might explain the situation to him by the aid of our chart, just as I had previously explained it to Mr. Phelan. Like Mr. Phelan, he soon appreciated the grave dangers of the situation, and unhesitatingly promised to give me his wholehearted support in averting them.

In the Senate, few obstacles were encountered, because

Senator Owen, in the early days before the Federal Reserve Act was passed, had accepted the doctrine which we were seeking to have adopted by the law. In fact, it may be recalled that the Federal Reserve Bill as sponsored by Senator Owen in the Senate, and as passed by that Chamber, contained a provision permitting Federal reserve notes to be counted as reserves, which was, in effect, what we were now asking for, although we were now seeking it in a form which was less objectionable to those who had so strongly committed themselves against the earlier proposal.

It would be interesting to relate some of the dramatic incidents which took place in connection with the task of steering the amendment through Congress, but it must suffice to say that in June, 1917 it passed both Houses. A statement to the press made by the Board on January 13th, 1917, at a time when our proposals had been submitted to Congress and had received sympathetic consideration in the Senate, although they had failed to make progress in the House, is given herein as Appendix Twenty-Five.

The importance of this new legislation can scarcely be overestimated, for it was the amendment relating to reserves which enabled the Reserve System to corral and mobilize the country's gold and thereby to finance, as well as it did, the unparalleled demands of the War. It is this amendment which gives the Reserve System the unequaled strength it commands to-day.

The Federal Reserve Board in its Annual Report for the year 1917 (page 13) makes the following comment upon the effect of the Amendment of June 21st, 1917:

> The gain in actual cash by the Federal reserve banks, following the amendments, may be best demonstrated by a comparison of their condition on June 1st (three weeks before the amendments were adopted) with their condition on August 3rd.
>
> On the earlier date the gold and lawful money held by

> Federal reserve banks and by Federal reserve agents amounted to $933,427,000, while on the latter date the total was $1,421,382,000, and for the same period the free gold—that is, the surplus over required reserves—increased by $300,000,000.

This modification of the law produced a fundamental change in the basic structure of the Reserve System and made it follow the same line of thought as the "United Reserve Bank" and the "National Reserve Association" plans. Dr. Willis has the following to say in connection with the amendment:[1]

> This modification . . . was a direct breach in the entire theory of the Reserve Act. In the original act provision had been made for a threefold reserve. This included: (1) a deposit with the reserve banks of a compulsory amount, (2) a holding of vault cash also compulsory up to a minimum sum, and (3) an intermediate amount which might be held in vault or transferred to reserve banks. The theory of the act had been that in times when reserve banks needed greater strength they would so alter their policy and adjust their rates as to attract this variable element of reserves to their own vaults, while at times when credit could properly be relaxed they would repel it and thus transfer to member banks the responsibility for enlargements of the volume of credit in the market, enabling them to proceed regardless of reserve bank policy. This plan was substantially developed upon the experience of the Bank of England and represented an adaptation of the "private" and "public" rate policy and practice of that bank[2] . . .

[1] Willis, *The Federal Reserve System*, pp. 1179–80.

[2] There are many reasons why the analogy of the Bank of England would not apply. There are no "member" banks in England; there are no compulsory balances; and whereas only a few huge branch banking institutions coöperate with the Bank of England, we have more than 27,000 banks in the United States. Moreover, England has a highly developed discount market which serves as a daily regulator of balances, while we have not. But, irrespective of these overwhelming differences, it is absolutely impossible to understand how any Federal reserve discount policy could draw gold out of the tills of member banks, or "repel it," so long as Federal reserve notes could not be counted as reserve money and so long as the law stipulated the minimum to be maintained in vault and reserve balance combined. No interest being allowed on these

> The new amendments abandoned the older theory and substituted for it the notion of obtaining and holding as large a proportion of reserve funds as possible, with a view to having at all times on hand a vast credit-granting power. Those who believed that reserve notes would figure largely in the reserves of member banks also predicted that this change—which had in effect although not in name been included in the amendments—would likewise greatly strengthen the credit inflating or extending power of the system . . .

In passing, it may be noted that Dr. Willis is still regretting the passage of these amendments and has not ceased urging Congress to turn back the hands of the clock by canceling what he erroneously calls the "war amendments," and to return to his "scientific" plan which would cripple the reserve power of the Reserve System. Actually, of course, it is not true that the Amendments of June 21st, 1917, were proposed as "war measures;" on the contrary, as we have seen, they had been repeatedly considered and urged by the Reserve Board before the War began.

In contrast to Dr. Willis, Senator Glass seems to be willing to bow to the evidence furnished in this respect by the record of the achievements of the Reserve System after the passage of these amendments. In summing up the services rendered by the Reserve System, he says:[1]

reserve balances, discount rates could by no stretch of the imagination affect the movement from tills to reserve bank balances or the reverse. It is quite impossible to give the doctrine propounded by Dr. Willis any practical meaning. It is odd, moreover, to see Dr. Willis designate the Bank of England's system as the only "scientific" one, when England is moving rapidly to-day toward a modification of her time-worn methods on lines following more nearly the theory of the Bank of the Netherlands, the National Bank of Switzerland, the Reichsbank, the Banque de France, the Swedish Riksbank, the Norwegian, Danish, and Austrian central banks; in other words, toward the theory guiding all other central banks and one which agrees entirely with the theory adopted in these amendments to the Federal Reserve Act.

[1] Glass, *ibid.*, pp. 305–306.

> The services of the reserve system in connection with what is called the "gold problem" should be mentioned in this same connection, especially as they have seldom been correctly appraised. At the close of the war we had on hand a substantial national stock of gold, but the post-war years brought immense transfers of the metal to our shores, as foreign countries adopted this mode of settling their obligations and as new production of gold found itself obliged to seek a market where the price was not regulated. The outcome was an increase in gold holdings up to an amount which is now variously estimated as anywhere from $4,000,000,000 to $4,500,000,000, or probably about one third of the visible gold supply of the world. This large holding of gold has of late years been held to the extent of almost two thirds in the vaults of the reserve banks. As it has come into the United States, it has been used by the member banks to which it was consigned for the purpose of paying off their obligations to the federal reserve banks of their respective districts. The federal reserve banks have held it as the basis for their outstanding credit. They have thus kept it from entering immediately into circulation and so constituting the foundation for an extended inflation in prices and values as it might have, had the system not been in existence. Whatever may be thought of the discount policy of the reserve system there can be no doubt that in one way or another the gold holdings referred to have been protected from the direct drafts which would otherwise have been brought to bear on them. Thus an important service to the general object of price stabilization has been rendered.

Whether or not one quite agrees with the economic theory here propounded, no one could suspect Senator Glass, from the expressions just quoted, of approving Dr. Willis's scheme for again scattering, among the eight thousand seven hundred member banks, a vast portion of the Reserve System's gold, and of once more reducing the aggregate of Federal reserve circulation outstanding to the amount of bills discounted by the reserve banks.

When the Federal Reserve Act was under consideration by Congress, Mr. Glass's opponents argued that it was bound to cause inflation. In reviewing this prediction, fourteen years after it was made, Senator Glass says:[1]

> None of the disasters prophesied by this distinguished statesman have yet broken upon the country as a result of the enactment of federal reserve legislation. The regional banks have the greatest reserve of gold ever assembled outside the bowels of the earth. Through their agencies was managed the most inconceivable flotation of war loans in the history of the universe; and to-day the prosperity of the nation seems inseparably associated with the maintenance and wise administration of the system.

But while Senator Glass thus stresses the point that the Reserve System did not cause inflation through the concentration of "the greatest reserve of gold ever assembled outside the bowels of the earth," he amazes us by his inconsistency when, in discussing in 1927 the proposals contained in the Senate bill of 1913, he reiterates his time-worn and disproved charges:[2]

> . . . the Senate tremendously accentuated the alleged "inflationary" features of the measure, if it did not make inevitable the greatest imaginable amount of inflation. At one stroke, in authorizing federal reserve notes to be counted by member banks as a reserve, it made possible inflation to the incredible amount of six billions of dollars, as computed by competent actuaries. By authorizing bank acceptances on domestic transactions, thus creating contingent liabilities of great volume with not one dollar of gold cover, it not only made certain credit expansion beyond approximation, but would have introduced an untried and exceedingly dangerous banking practice.

It is well known, of course, that ever since 1917 the much denounced "domestic acceptances" have been authorized by

[1] Glass, *ibid.*, p. 202.
[2] Glass, *ibid.*, p. 200.

an amendment to the Federal Reserve Act and, not only have they not caused the predicted inflation, but they have proved most beneficial to the agricultural sections of the country and have been of great assistance in widening the American discount market. The Amendments of 1917, furthermore, permitted Federal reserve notes to take the place of gold and lawful money in the tills of member banks. It is difficult to follow Senator Glass's process of reasoning when he defends the Reserve System against the charge of having produced inflation and, at the same time, reiterates his contention that these two Senate proposals, i. e. the one relating to domestic acceptances and the other permitting Federal reserve notes to take the place of gold and lawful money in the tills of member banks, which, in effect, have now been in force since 1917, would not only have made "credit expansion certain beyond approximation, but would have introduced an untried and exceedingly dangerous banking practice."[2]

The history of the "Gold Settlement Fund"[2] furnishes another striking illustration of the inevitable advance of the twelve separate reserve banks toward an organically united System. The "Gold Settlement Fund"[2] established to facilitate the settlement of balances between Federal reserve banks has been one of the highest achievements of the Reserve System. It enabled the reserve banks to adjust by means of simple book entries the debit and credit balances resulting from their huge daily operations and to avoid wasteful shipments of gold and currency. The telegraphic transfer system, established as a corollary of the organization of the "Gold Settlement Fund," has also proved of the greatest economic advantage, not only to the member banks, but to the entire country.

The development of the operations of the fund on its present gigantic lines was due largely to the Amendment of June, 1917, which gave the Federal Reserve Board clearly defined authority to operate a Gold Clearing Fund, to the

Treasury authority to act as custodian of the gold deposited with it by the Federal reserve banks, and to the reserve banks the right to treat gold deposited in this fund as part of their required reserves.[1] The outstanding importance of this amendment, however, lay in the fact that, while until then there had been no lawful organic cohesion between the reserve banks—coöperation between them depending entirely upon the administrative measures of the Reserve Board—the law now created frankly and unequivocally an organic link which united twelve regional banks into a single coördinated system of strength and efficiency.

The original Federal Reserve Act had provided that the Reserve Board might "act as a clearing house." A similar provision had already been embodied in the "United Reserve Bank" and the "National Reserve Association" plans; but with the great difference that the proposals therein contained dealt with corporate bodies, which could readily act as clearing houses, while the Federal Reserve Act made it impossible for the Reserve Board to exercise such a function, because the Act had given the Board neither a corporate nor a financial responsibility. Whether the writers of the Act avoided incorporating the Board and neglected to endow it with an adequate capital for fear it would thereby approach the dreaded appearance of a central bank, or whether in taking over the provision from the earlier proposals they had merely failed to appreciate the needs of the problem, is an open question. In any case, the Board, as such, until a change was made in the Act, could not itself exercise a function which Congress had evidently intended it to exercise.

In its quest for a remedy, the Board debated the possibility of having the Richmond Federal Reserve Bank open a branch at Washington for the purpose of using it as the "clearing house" for the reserve banks, or of authorizing the Federal Reserve Bank of Chicago, on account of its central location,

[1] The amended sections will be found in Addendum IV herein.

to assume this function; but for obvious reasons both of these plans had to be abandoned. A temporary plan was then devised under which the reserve banks paid into the Treasury or Subtreasuries gold certificates in large denominations, while, once a week, the Treasury issued a corresponding amount of new gold certificates in the names of those reserve banks to which, in accordance with the certification of the Reserve Board, a balance in the clearing between reserve banks was due. This procedure, however, was clumsy and circuitous, and enabled some critics to make the charge of "extra-legality." Doubt was expressed by such critics as to whether gold held in this fund could lawfully be counted by reserve banks as part of their reserve. Hence the necessity of an amendment which, as already stated, was obtained in June, 1917. If the Reserve System, in its interdistrict operations, functions as a unit to-day; if the Gold Settlement Fund manages transactions involving billions of dollars a year; and if the gigantic operations of the Treasury, in peace and in war, have been carried on for a decade so as hardly ever to cause a ripple in the money market, it is largely due to the establishment and perfection of this machinery. But it is a far cry from a plan of twenty entirely distinct and independent regional banks to the present system of twelve reserve banks united by the law into one interlocking organization.

It is tempting, but would lead too far afield, to trace in detail the evolution of the Federal Reserve System's attitude regarding the membership of state banks and trust companies. A review of the long list of drafts of regulations and amendments, submitted from time to time to and by the Board, would illustrate the slow and painful progress from a narrow conception of the Reserve System as a rediscounting machine, designed primarily for the benefit of national banks (and state institutions only insofar as they would restrict their own functions substantially to those exercised by national banks), to the adoption of the broader policy of liberalizing the powers

of national banks, so as to enable state institutions to enter the System on a basis of parity without the loss of valuable powers and privileges. It would be equally instructive to show by the evidence of the drafts of regulations and amendments how, step by step, the acceptance powers of member banks were enlarged and how the Reserve System's attitude toward acceptance operations, narrow and provincial in the beginning, became more and more liberal, culminating in the creation of a credit system extending over the entire world. In order to enable the reader thoroughly to grasp the true scope and meaning of the amendments here discussed, and in order to place him in a position fully to understand their far-reaching effect upon the ultimate development of the Reserve System, the sections of the Federal Reserve Act bearing upon membership of state banks and trust companies, note issue and reserves, the Gold Settlement Fund, the powers of reserve banks, and the powers of member banks to accept, are herein reprinted in Addendum IV, which shows both the original text of the respective clauses and the text as it stood after the passage of the Amendments of June 21st, 1917. The effects of these amendments may readily be seen from four charts presented on the following pages. These charts tell their own story even when due allowance is made for other factors, such as the direct and indirect influence of the War, which aided and accelerated the developments indicated by the graphs.[1]

[1] A study of these charts may prove instructive to the readers of Dr. Willis's book on *The Federal Reserve System* in view of the many severe criticisms of the first Board contained therein. He charges the first Board, not only with bias and a lack of sympathy with regard to the Act, but also with neglect to strengthen and prepare the System for the eventuality of the strain of the impending war emergencies. It may suffice to cite here two of his statements along these lines. The first may be found on page 836 as follows:

"The fact that the war was in progress and that eventually there was at least a possibility of American participation, must from time to time have been present to the minds of every member of the group but was ignored by all in the absorption of routine work and the process of playing the daily game of politics. Thus there was no distinct provision against the future, no building up of strong

There is still another development which should be mentioned here as signifying gradual progress in the perfection of the Reserve System. This was a development bitterly opposed by both Mr. Glass and Dr. Willis, but as we see it to-day it was a development which contributed very largely to the present efficiency of the Reserve System.

The position of the Reserve Board, as designed by the Act, was bound to prove exasperatingly difficult and trying. The office was burdened with the handicap, commonly imposed upon so many branches of administration in a democracy, of a system of checks and counter-checks—a paralyzing system which gives powers with one hand and takes them away with the other. To a certain extent, the consequences of the imposition of such a system have to be accepted as the price a country must pay in order to safeguard its democracy. Success or failure in such cases generally depends on the wisdom with which the balancing of the checks and counter-checks in a legislative act is handled, and on the intelligence with which, later on, the act is administered.

When the writers of the Federal Reserve Act began to deal

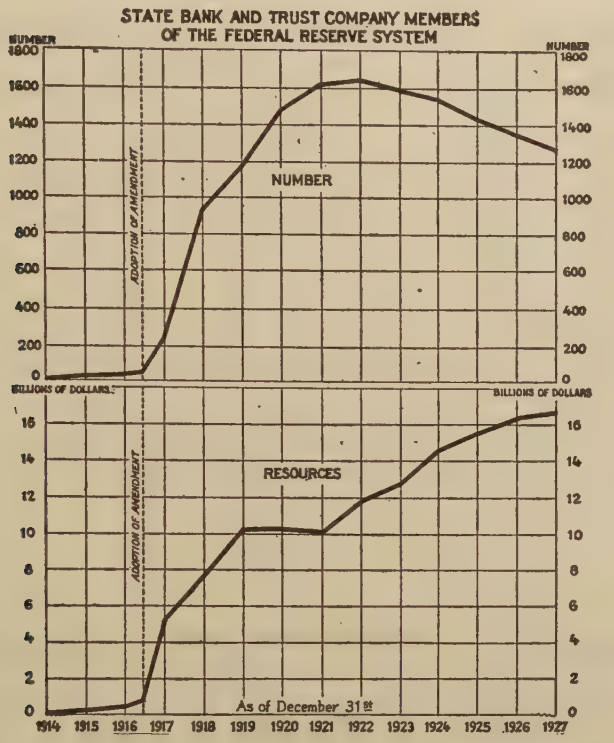
financial machinery which should be used in the event of the difficulty already threatening and eventually unavoidable."

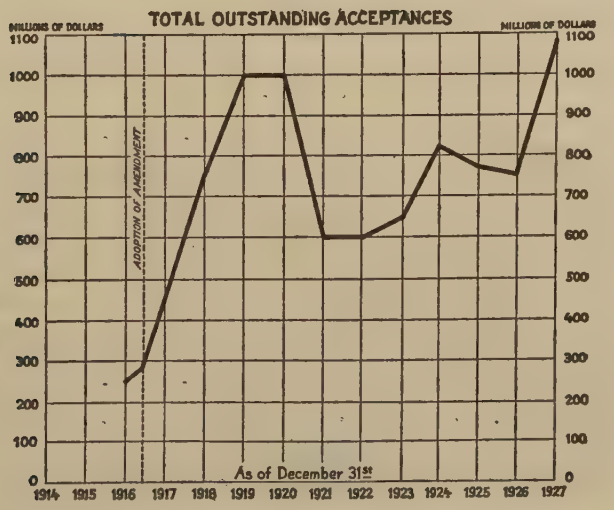
The second appears on page 619, and reads:

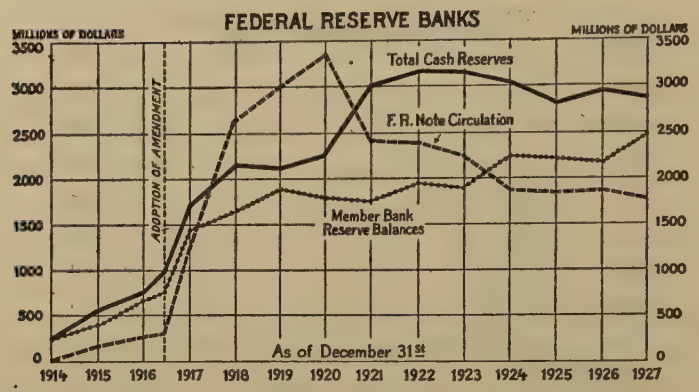
". . . None of the members had played any part in the actual work of forwarding the adoption of the Federal Reserve Act, while at least one had been directly opposed to its enactment, and at least one other had had membership in an organization which had been distinctly hostile throughout the whole formative period of the new law. The Secretary of the Treasury, as has been seen, had, moreover, sought to substitute another measure for the original bill or plan, and the same was true of the Comptroller of the Currency, so that the new choices represented in this respect nothing different from the early attitude of important members of the administration.

Nevertheless, it was true that the Board as first constituted was predominantly doubtful of, or actually hostile to, the law which it had been set to administer. . . ."

One is tempted to inquire whether a surgeon fighting a cancerous growth may be fairly considered as "hostile" to the patient or to the disease.

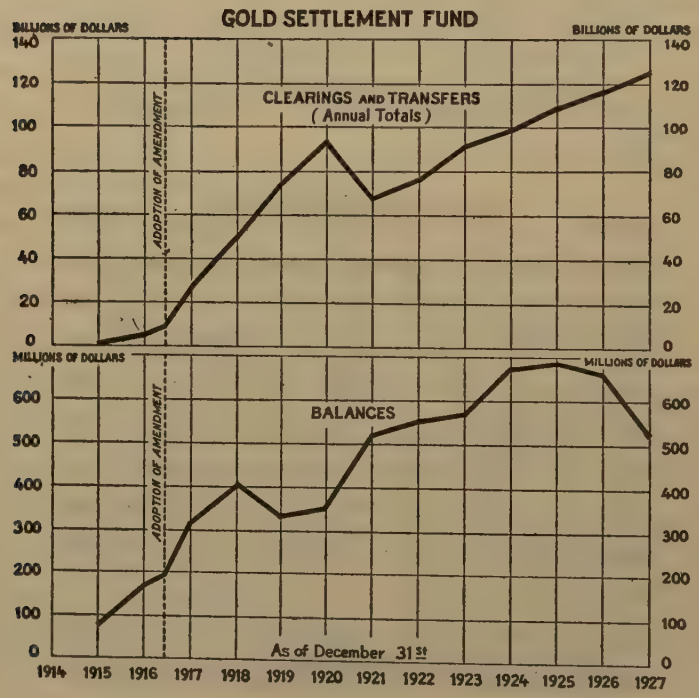

STATE BANK AND TRUST COMPANY MEMBERS
OF THE FEDERAL RESERVE SYSTEM
NUMBER
NUMBER
ADOPTION OF AMENDMENT
BILLIONS OF DOLLARS
BILLIONS OF DOLLARS
RESOURCES
As of December 31st
1914 1915 1916 1917 1918 1919 1920 1921 1922 1923 1924 1925 1926 1927


TOTAL OUTSTANDING ACCEPTANCES
BILLIONS OF DOLLARS
MILLIONS OF DOLLARS
ADOPTION OF AMENDMENT
As of December 31st
1914 1915 1916 1917 1918 1919 1920 1921 1922 1923 1924 1925 1926 1927



NOTE 1–*Cash reserves include gold, legal tender notes, and silver.*

" 2–*Member bank reserve balances prior to 1917 are shown net, i.e. after deduction of amounts of items in process of collection.*



with the link that was to connect the reserve banks, they evidently first thought of it as no more than a supervisory organ. Mr. Glass, as we have seen, proposed to charge the Comptroller of the Currency with this function, while President Wilson envisaged an "altruistic Board" as the capstone of the System. When the President discussed with bankers their plea that the Board should include members of the banking profession delegated by the reserve banks, he asked them if they knew of any important government board of control on which private interests were represented.[1]

It is to be regretted that, in their reply, the bankers did not raise the question whether the Federal reserve banks could fairly be considered as "private interests." One would hardly designate the Bank of England, the Banque de France, or the Reichsbank as "private interests" and, as each Federal reserve bank is practically a central bank in itself, the wish to secure for these Federal reserve banks a modest minority representation on the Board was entirely justified. The recommendation seemed all the more warranted as it was suggested that these Federal reserve bank representatives might be chosen subject to the approval of, and final appointment by, the President. The bankers, furthermore, should have stressed the point that the first thing to be agreed upon was whether the Reserve Board was in reality going to be a

[1] Glass, *ibid.*, p. 116. Senator Glass indicates that this question convinced the bankers of the weakness of their position, since no "convincing reply" was possible. Evidently Senator Glass brushes aside the fact that there are bankers on the boards of directors of many of the European central banks. On the board of the Bank of England, there are to-day partners of the Morgans, Barings, Lazards, and Schroeders. In London, however, these are termed "merchant bankers"—a fact which has led to the mistaken assumption over here that bankers are excluded. Of the twenty-four directors of the Bank of England, outside the governor and the deputy governor, at least eight at present are bankers in our meaning of the word. The General Council of the Reichsbank, as reorganized under the Dawes Plan, consists of fourteen members (in addition to the president); of these—seven are representatives of foreign countries and seven members represent Germany. All of the seven German representatives are private bankers or bank officers.

purely supervisory board of control, or whether it was to be a body endowed with important executive and administrative powers. They might then have added that, if it was to be a purely supervisory board, the Reserve System was doomed. If the Reserve System was to retain the character of a regional organization, with actual operations left in the hands of the reserve banks, it was obvious that the System could not be expected to function as a coördinated unit unless the Reserve Board was vested, not only with the powers of supervision, regulation, and approval, but also with powers, expressed or implied, to influence and, if need be, to direct certain operations of the twelve reserve banks so as to assure their harmonious coöperation.

As the formulation of the law proceeded, many attempts were made to find a satisfactory answer to the tantalizing puzzle of how to safeguard the autonomy of the reserve banks while giving, at the same time, adequate coördinating and directing powers to the Reserve Board. This phase of the problem will be more fully dealt with in subsequent portions of the volume.

It was the desire to carry the theory of a divided control into the directorates of the reserve banks that led the writers of the Federal Reserve Act to devise the perfectly logical and commendable plan of having six directors (Class "A" and Class "B") elected by the member banks, and three directors (Class "C") appointed by the Reserve Board. But they pushed the principle of dual control to an extreme when they begot that somewhat amphibious creature, the Federal reserve agent, and compelled him to divide his mind and heart in two, one half to function as the mouthpiece and organ of the Reserve Board, and the other as a director of the reserve bank. He was to be the Reserve Board's ambassador and official observer; but, at the same time, in the capacity of a Class "C" director, his responsibility to the stockholders was on a par with that of the Class "A" and Class "B" directors.

Who was actually to manage the affairs of a reserve bank had been left an open question in the Federal Reserve Act, which provided merely that the three Class "C" directors, constituting in each bank only a minority of the board of directors, acting together with the six Class "A" and Class "B" directors, were to appoint the managing officer of the bank. Obviously, the Federal reserve agent, appointed by the Board, could not be made the active manager of a reserve bank, because that would have placed the Board in a position of responsibility for the operations of the reserve bank, whereas such responsibility plainly rested with the directors, a majority of whom were elected by the member banks. The only possible solution was, therefore, to make the Federal reserve agent the presiding officer, ambassador, and observer, while the function of heading the actual operations of the bank was vested in a president or manager appointed by the combined action of the three classes of directors of the reserve banks. In the minds of the framers of the Federal Reserve Act, there seems to have prevailed some vague idea that the Federal reserve agent should be the overtowering personality, with the manager as the subordinate. But, as already stated, this, in effect, would have made the Reserve Board responsible for the operations of the reserve banks; it would have vitiated the theory of the autonomy of the reserve banks; it would have been unacceptable to the member banks; indeed, it would have created the very central bank with branches which the writers of the Act had so passionately denounced.

In these circumstances, if the reserve banks were to develop as independent institutions; if, as such, they were to assume positions of leadership in their communities; and if they were to supply the Reserve Board with the instruments of influence and power which were indispensable for the success of the System, it followed that an effort would have to be made to secure men of the highest possible type for the managerial position. If this was the aim to be accomplished, the office of a

reserve bank manager would have to be endowed with all possible prestige so as to render it attractive to men of high standing in the several communities. With this end in view, I urged the Board to authorize the title of "governor" for the heads of the reserve banks and, happily, the Board approved the suggestion, although neither Senator Owen nor Mr. Glass were in sympathy with it. There were also some members of the Board who subsequently regretted this action. They feared that the Board, by creating these positions of prestige, had weakened its own standing. I never shared this view, for I always believed, as I do to-day, that strong leadership on the part of the reserve banks in their several districts is a prerequisite for the success of the entire System.

It was a very difficult task to find properly qualified men willing to accept positions as Federal reserve agents and governors, particularly when the salaries that a system without any proven earning power could offer were far below what men of the necessary ability could earn in other positions. In these circumstances, an appeal to men to join the staff of the Reserve System, either as governors or Federal reserve agents, could meet with favorable response only where the willingness to render public service outweighed the natural desire for material advancement. Beyond doubt, the country owes a debt of deep gratitude to the leaders among the agents and governors who, as pioneers, were willing to sacrifice their private interests in order to accept these toilsome and unremunerative positions. Without them, the System could never have attained the success of which the nation is so justly proud.

In most cases, the material sacrifice was smaller for the governors than for the Federal reserve agents, because as representatives of the Reserve Board they were regarded as holding an "honorary" office, and it was thought that, like Reserve Board members, they should be willing to accept the smaller compensation customary for that type of position. But Federal reserve agents were, as a consequence, entitled to

believe that, in keeping with this theory, their office would be one of particular dignity. They had a right to assume that, if representing the Reserve Board on their respective directorates was to be their outstanding duty, the Board would consider them as a medium for whatever messages it wished to convey to the reserve banks. After an initial attempt to adopt this method, the Board, however, found it impossible to have a common policy permeate the System, if it declined *all* contact with the governors; and, as years went by, it became more and more the Board's practice to communicate with the governors directly concerning matters of operation, while it continued, in theory, to hold that official messages and communications concerning general policy and conditions should be addressed to the Federal reserve agents. Fourteen years of practical operation have shown that, even where the best spirit prevails on all sides, the dualism in the administration of the reserve banks has proved a source of perplexity, confusion, and, at times, irritation and discouragement. A problem has been created which, for all three parties concerned, the Board, the Federal reserve agents, and the governors, has proved to be practically impossible of a satisfactory solution.[1]

From the foregoing, it may be readily perceived how impossible it would have been for the Board to direct a system of twelve reserve banks if a policy of keeping these banks wide apart from one another, with the Board serving as the sole center and instrument of communication, had been pursued. It was obvious that in deciding questions of technical routine, as well as in establishing a uniform understanding of the Board's rules, regulations, and general policies, harmonious

[1] The experience of past years seems to indicate that a great many difficulties would be avoided were the three Class "C" directors simply to serve as chairman and vice chairmen of the board of directors, and if functions such as the handling of the Federal reserve notes and the making of certain reports were separated from the chairmanship and placed in the hands of the Federal reserve agent, whose office would then be confined more or less to the activities now exercised by the assistant Federal reserve agent.

coöperation could only be brought about by establishing contacts between the heads of the twelve reserve banks, both governors and Federal reserve agents. These considerations led to the early conclusion that, if the System was to operate as a coördinated whole, the governors of the reserve banks and the Federal reserve agents would, from time to time, have to be brought together in joint conferences with the Reserve Board. During the period of the initial development of the System, these meetings proved to be of the greatest value, because they gave the Board a much needed opportunity to preach its gospel and to instill in the hearts and minds of the officers of the banks a wider conception of the aims and duties of the System, as against the petty, sectional point of view which tended to prevail in some districts.

The conferences were, however, of even greater and continuing importance with regard to the momentous questions of the discount and open-market operations, for which a basis for close coöperation between the Board, on the one hand, and the reserve banks, on the other, had to be found as a prerequisite for a satisfactory functioning of the System.

With regard to the establishment of discount rates, the law, after many changes of heart on the part of the framers of the Act, had finally left the power of naming the rate with the reserve banks, but the power to review such rates and to determine them definitely was left with the Board. The dangerous possibilities resulting from this wide-open compromise provision, which left all sides unprotected, are treated more fully in Chapter XII and Addendum I. Here, it suffices to say that the two conflicting intentions of the Act—the one to create autonomous banks and the other to create a supreme Board—cannot be harmonized by either the banks or the Board claiming or receiving from Congress an exclusive right; solution of this problem can only be found in voluntary agreement and intelligent coöperation on the part of all concerned. If the Board is to avoid acts of coercion and if at the same time individ-

ual reserve banks are to be prevented from playing a lone and selfish game, not in keeping with the broad policy which the Board, after close study and consultation, has determined as being in the best interests of the country as a whole, joint meetings at which the System's problems are thoroughly discussed, and at which a broad understanding of the general situation is secured, are indispensable.

But the most fruitful field for these governors' conferences was found in the unexplored question of open-market operations. The law confers upon each reserve bank the power, individually and independently, to engage in open-market operations. The hopeless confusion into which the System found itself precipitated when each reserve bank, for itself, began to engage in these transactions, could only be remedied by devising a scheme for voluntary coöperation under a common plan. Since the Reserve Board had authority only to write rules and regulations for these operations, but had no specific power to engage in, or to direct them, the ultimate solution was found in having the reserve banks elect a Governors' Executive Committee which, to-day, under the auspices of the Board, handles these open-market transactions for the common account of all reserve banks desiring to participate therein, and which, in a similar manner, acts as the medium for uniting the reserve banks in their important transactions with foreign central banks.

While the governors' conferences thus proved invaluable, they nevertheless, from time to time, met with very strong and determined opposition. In fact, for a while, they had to be abandoned on account of the opposition raised against them. It came from members of the Board, as well as from certain individuals "on the hill" who believed that the conferences were an illegal or extra-legal attempt to create a central bank. While, of course, there was nothing illegal or extra-legal about the plan, it certainly is true that it brought the System one step nearer to a coördinated central banking system, such as

had been envisaged by the United Reserve Bank Plan and the Aldrich Plan.

The importance of a definite open-market policy, coördinated with the Reserve System's discount policy, is better understood to-day than it was when the Federal Reserve Act was written. With this phase of the problem we shall deal more fully in later chapters; suffice it to say here, without fear of contradiction, that, if in these operations each reserve bank had been permitted to pursue a course of its own, the System would have failed. In some form or other, a close coöperation between the reserve banks had to be brought about. The law having given the reserve banks a position of autonomy in the matter of open-market transactions, it was nothing but an act of wisdom on their part voluntarily to surrender it in order to create a means of coördinating their individual operations. In their own interests, and in order to avoid jealousies and attacks, it was prudent for the reserve banks to seek the coördinating influence of the Board in these joint operations, even though the law had found it impossible and undesirable to give the Board specific powers of direction in this respect. Conversely, even though in the matter of fixing the rediscount rates the law placed the ultimate power to enforce its will in the hands of the Federal Reserve Board, the latter, having regard for its own protection and the best interests of all concerned, would be ill-advised to resort to coercion instead of making every effort to secure voluntary coöperation on the part of the banks.

As was predicted long ago, the impelling need of a common discount and open-market policy was bound to bring autonomous regional banks together if, to use the language of Dr. Willis, the Federal Reserve System was "to fulfill its entire function as a genuine central banking system."[1]

It is interesting to observe how those who had so passionately condemned the Aldrich scheme as tainted with the charac-

[1] Willis, *The Federal Reserve System*, Preface, page III.

teristics of a central bank were finally obliged to admit that the Federal Reserve System could not be administered effectively unless it was frankly operated as a coherent central banking system.

Upon a certain occasion, Senator Glass expressed his dissatisfaction with the Reserve Board, because the reserve banks had shown themselves unwilling to do certain things which he thought they should do. He suggested that the Board should force the banks into submission.

"But, Mr. Glass," I said, with a smile, "the Board has no power in the premises to force the banks and, moreover, would not that make it a 'central bank' ?"

"Oh, h—," he answered, "it *is* a central bank."

I have no doubt my colleagues will remember the incident, because it was so intensely amusing that I promptly related it to them.

CHAPTER VIII

THE ALDRICH BILL AND THE FEDERAL RESERVE ACT: A JUXTAPOSITION OF TEXTS

BEFORE presenting our own conclusions with regard to the similarities and dissimilarities between the National Reserve Association Plan and the Federal Reserve Act, conclusions which are embodied in Chapter X, it seemed advisable to offer to the reader an opportunity of examining for himself a comparison of these two bills, printed in parallel columns. In order to make it as easy as possible to grasp the essential points in such a juxtaposition, the paragraphs of the Aldrich Bill have, in general, been printed in their original sequence, while the Federal Reserve Act has been cut into separate paragraphs, and these have been placed beside the corresponding passages of the Aldrich Bill. A running commentary has been included at the foot of each section.

Serious students are earnestly requested to examine closely this juxtaposition. Inasmuch, however, as many readers may not find the time to dissect and compare carefully the legal phraseology of the related sections of the two documents, there has been prepared from this juxtaposition, and printed immediately following it, as Chapter IX, *An Analytical Comparison of the Aldrich Bill and the Federal Reserve Act Based on the Juxtaposition of Texts Shown in Chapter Eight*, which in abstract form sets forth in parallel columns only the high points of the two bills, so that their similarities and correspondences may easily be noted.[1]

The author makes free, however, to suggest to his readers

[1] This abstract is largely the work of Mr. R. W. Robey.

to cast at least a cursory glance upon the juxtaposition of texts in Chapter VIII and not to omit perusal of the running commentary accompanying the comparison, as some of the comments present essential elaborations.

Some duplication will be found in passages contained in the commentary and in the text of the book. This is explained by the fact that the original work began with the composition of this comparison and its commentary, which served as working sheets for the book and which it was thought best therefore to leave undisturbed.

ABBREVIATIONS:

N. R. A. National Reserve Association Bill

F. R. A. Federal Reserve Act

U. R. B. United Reserve Bank of the United States (Paul M. Warburg scheme)

M. M. S. Where in the comparison of related sections the substance has been found to be the same, making due allowance for differences in language which are of no particular importance or necessarily follow from structural differences in the two bills, the letters "M. M. S." will be used, meaning "*M*utatis *M*utandis the *S*ame."

Matter printed in bold-faced type indicates similarities

National Reserve Association Bill
(The Aldrich Bill)

SHARE CAPITAL

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That the National Reserve Association of the United States be, and it is hereby, created and established for a term of fifty years from the date of filing with the Comptroller of the Currency a certificate of paid-in capital stock as hereinafter provided. It shall have an authorized capital equal in amount to twenty per centum of the paid-in and unimpaired capital of

all banks eligible for membership

in said National Reserve Association. Before said association shall be authorized to commence business two hundred million dollars of the capital stock shall be subscribed and one hundred million dollars of its capital shall be paid in cash.

(Continued on page 182)

Federal Reserve Act

SHARE CAPITAL

SEC. 2. Under regulations to be prescribed by the organization committee, every national banking association in the United States is hereby required, and

every eligible bank

in the United States and every trust company within the District of Columbia, is hereby authorized to signify in writing, within sixty days after the passage of this Act, its acceptance of the terms and provisions hereof. When the organization committee shall have designated the cities in which Federal reserve banks are to be organized, and fixed the geographical limits of the Federal reserve districts, every national banking association within that district shall be required within thirty days after notice from the organization committee, to subscribe to the capital stock of such Federal reserve bank in a sum equal to six per centum of the paid-up capital stock and surplus of such bank, one-sixth of the subscription to be payable on call of the organization committee or of the Federal Reserve Board, one-sixth within three months and one-sixth within six months thereafter, and the remainder of the subscription, or any part thereof, shall be subject to call when deemed necessary by the Federal Reserve Board, said payments to be in gold or gold certificates.

(*Continued on page 183*)

National Reserve Association Bill
(The Aldrich Bill)

The capital stock of said association

shall be divided into shares of one hundred dollars each. The outstanding capital stock may be increased from time to time as subscribing banks increase their capital or as additional banks become subscribers or may be decreased as subscribing banks reduce their capital or leave the association by liquidation.

The head office of the National Reserve Association shall be located in Washington, in the District of Columbia.

COMMENT:

The principle is the same. A certain capital is to be subscribed by all member banks (national and state) and half of the amount subscribed is to be paid in.

The differences are immaterial. The N. R. A. Bill stipulates member bank subscriptions of 20 per cent of their paid-in capital and a minimum of $200,000,000 total subscription for the N. R. A. The F. R. A. stipulates member bank subscriptions of 6 per cent of capital *and surplus* and a minimum of $4,000,000 total subscription for each Federal reserve bank. (At

Federal Reserve Act

SEC. 5. The capital stock of each Federal reserve bank

shall be divided into shares of $100 each. The outstanding capital stock shall be increased from time to time as member banks increase their capital stock and surplus or as additional banks become members, and may be decreased as member banks reduce their capital stock or surplus or cease to be members.

. . .

SEC. 2. No Federal reserve bank shall commence business with a subscribed capital less than $4,000,000.

---

the close of 1928, the paid-in capital of the Federal reserve banks was approximately $147,000,000 with a surplus of 254 millions.)

Shares of $100 and provisions for increase and decrease are the same.

National Reserve Association Bill
(The Aldrich Bill)

INCORPORATION, CHARTER, AND POWERS

SEC. 2. **Upon duly making and filing with the Comptroller of the Currency the certificate hereinafter required the National Reserve Association of the United States shall become a body corporate and as such and by that name shall have power—**

First. To adopt and use a corporate seal.

Second. To have succession for a period

of fifty years from the date of said certificate.

Third. To make all contracts necessary

and proper to carry out the purposes of this Act.

Fourth. To sue and be sued, complain and defend, in any court of law or equity,

as fully as natural persons.

Federal Reserve Act

INCORPORATION, CHARTER AND POWERS

SEC. 4. . . . **Upon the filing of such certificate with the Comptroller of the Currency as aforesaid, the said Federal reserve bank shall become a body corporate and as such, and in the name designated in such organization certificate, shall have power—**

First. To adopt and use a corporate seal.

Second. To have succession for a period

of twenty years from its organization unless it is sooner dissolved by an Act of Congress, or unless its franchise becomes forfeited by some violation of law.

Third. To make contracts.

Fourth. To sue and be sued, complain and defend, in any court of law or equity.

National Reserve Association Bill
(The Aldrich Bill)

Fifth. To elect or appoint directors and officers

in the manner hereinafter provided

and define their duties.

Sixth. To adopt by its board of directors by-laws not inconsistent with this Act, regulating the manner in which

its property shall be transferred,

its general business conducted, and the privileges granted to it by law exercised and enjoyed.

Seventh. To purchase, acquire, hold, and convey real estate as hereinafter provided.

Eighth. To exercise by its board of directors or duly authorized

committees,

officers, or agents,

subject to law,

all the powers

and privileges

conferred upon the National Reserve Association by this Act.

COMMENT:

M.M.S.—except that the National Reserve Association Bill provides for succession for *fifty* years, while the Federal Reserve Act has it for *twenty* years.

Federal Reserve Act

Fifth. To appoint by its board of directors, such officers and employees as are not otherwise provided for in this Act, to define their duties,

require bonds of them and fix the penalty thereof, and to dismiss at pleasure such officers or employees.

Sixth. To prescribe by its board of directors, by-laws not inconsistent with law, regulating the manner in which its general business may be conducted, and the privileges granted to it by law may be exercised and enjoyed.

Seventh. To exercise by its board of directors, or duly authorized officers or agents, all powers specifically granted by the provisions of this Act

and such incidental powers as shall be necessary to carry on the business of banking within the limitations prescribed by this Act. . . . But no Federal reserve bank shall transact any business except such as is incidental and necessarily preliminary to its organization until it has been authorized by the Comptroller of the Currency to commence business under the provisions of this Act.

National Reserve Association Bill
(The Aldrich Bill)

MEMBERSHIP

SEC. 3. All national banks,

and all banks or trust companies chartered by the laws of any State of the United States

or of the District of Columbia, complying with the requirements for membership in the said National Reserve Association, hereinafter set forth,

may subscribe to its capital

to an amount equal to twenty per centum of the paid-in and unimpaired capital of the subscribing bank, and not more nor less; and

each of such subscribing banks shall become a member

of a local association as hereinafter provided. Fifty per centum of the subscriptions to the capital stock of the National Reserve Association shall be fully paid in; the remainder of the subscriptions or any part thereof shall become a liability of the subscribers, subject to call and payment thereof whenever necessary to meet the obligations of the National Reserve Association under such terms and in accordance with such regulations as the board of directors of the National Reserve Association may prescribe.

The subscriptions of a bank or trust company incorporated under the laws of any State or of the District of Columbia to the

Federal Reserve Act

MEMBERSHIP

SEC. 9.

Any bank

incorporated by special law of any State, or

organized under the general laws of any State or of the United States, may make application

to the reserve bank organization committee, pending organization, and thereafter to the Federal Reserve Board

for the right to subscribe to the stock

of the Federal reserve bank organized or to be organized within the Federal reserve district where the applicant is located. The organization committee or the Federal Reserve Board, under such rules and regulations as it may prescribe, subject to the provisions of this section,

may permit the applying bank to become a stockholder

in the Federal reserve bank of the district in which the applying bank is located. Whenever the organization committee or the Federal Reserve Board shall permit the applying bank to become a stockholder in the Federal reserve bank of the district, stock shall be issued and paid for under the rules and regulations in this Act provided for national banks which become stockholders in Federal reserve banks.

National Reserve Association Bill
(The Aldrich Bill)

capital stock of the National Reserve Association shall be made subject to the following conditions:

First. That (*a*) if a bank, it shall have a paid-in and unimpaired capital of not less than that required for a national bank in the same locality; and that (*b*) if a trust company, it shall have an unimpaired surplus of not less than twenty per centum of its capital, and if located in a place having a population of six thousand inhabitants or less shall have a paid-in and unimpaired capital of not less than fifty thousand dollars; if located in a city having a population of more than six thousand inhabitants and not more than fifty thousand inhabitants, shall have a paid-in and unimpaired capital of not less than one hundred thousand dollars; if located in a city having a population of more than fifty thousand inhabitants and not more than two hundred thousand inhabitants shall have a paid-in and unimpaired capital of not less than two hundred thousand dollars; if located in a city having a population of more than two hundred thousand inhabitants and not more than three hundred thousand inhabitants shall have a paid-in and unimpaired capital of not less than three hundred thousand dollars; if located in a city having a population of more than three hundred thousand inhabitants and not more than four hundred thousand inhabitants shall have a paid-in and unimpaired capital of not less than four hundred thousand dollars, and if located in a city having a population of more than four hundred thousand inhabitants shall have a paid-in and unimpaired capital of not less than five hundred thousand dollars.

Federal Reserve Act

The organization committee or the Federal Reserve Board shall establish by-laws for the general government of its conduct in acting upon applications made by the State banks and banking associations and trust companies for stock ownership in Federal reserve banks. Such by-laws shall require applying banks not organized under Federal law to comply with the

National Reserve Association Bill
(The Aldrich Bill)

Second. That it shall have and agree to maintain against its demand deposits a reserve of like character and proportion to that required by law

of a national bank in the same locality: *Provided, however,* That deposits which it may have with any subscribing national bank, State bank, or trust company in a city designated in the national banking laws as a reserve city or a central reserve city shall count as reserve in like manner and to the same extent as similar deposits of a national bank with national banks in such cities.

Third. That it shall have and agree to maintain against other classes of deposits the percentages of reserve required by this Act.

Fourth. That it shall agree to submit to such examinations and to make such reports as are required by law and to comply with the requirements and conditions imposed by this Act and regulations made in conformity therewith.

Federal Reserve Act

reserve and capital requirements and to submit to the examination and regulations

prescribed by the organization committee or by the Federal Reserve Board. No applying bank shall be admitted to membership in a Federal reserve bank unless it possesses a paid-up unimpaired capital sufficient to entitle it to become a national banking association in the place where it is situated, under the provisions of the national banking Act.

Any bank becoming a member of a Federal reserve bank under the provisions of this section shall, in addition to the regulations and restrictions hereinbefore provided, be required to conform to the provisions of law imposed on the national banks respecting the limitation of liability which may be incurred by any person, firm, or corporation to such banks, the prohibition against making purchase of or loans on stock of such banks, and the withdrawal or impairment of capital, or the payment of unearned dividends, and to such rules and regulations as the Federal Reserve Board may, in pursuance thereof, prescribe.

Such banks, and the officers, agents, and employees thereof, shall also be subject to the provisions of and to the penalties prescribed by sections fifty-one hundred and ninety-eight, fifty-two hundred, fifty-two hundred and one, and fifty-two hundred and eight, and fifty-two hundred and nine of the Revised Statutes. The member banks shall also be required to make reports of the conditions and of the payments of dividends to the comptroller, as provided in sections fifty-two hundred and eleven and fifty-two hundred and twelve of the Revised Statutes, and shall be subject

National Reserve Association Bill
(The Aldrich Bill)

Federal Reserve Act

to the penalties prescribed by section fifty-two hundred and thirteen for the failure to make such report.

. . .

SEC. 19. If a State bank or trust company is required by the law of its State to keep its reserves either in its own vaults or with another State bank or trust company, such reserve deposits so kept in such State bank or trust company shall be construed, within the meaning of this section, as if they were reserve deposits in a national bank in a reserve or central reserve city for a period of three years after the Secretary of the Treasury shall have officially announced the establishment of a Federal reserve bank in the district in which such State bank or trust company is situate.

. . .

SEC. 2. . . . The shareholders of every Federal reserve bank shall be held individually responsible, equally and ratably, and not one for another, for all contracts, debts, and engagements of such bank to the extent of the amount of their subscriptions to such stock at the par value thereof in addition to the amount subscribed, whether such subscriptions have been paid up in whole or in part, under the provisions of this Act.

Any national bank failing to signify its acceptance of the terms of this Act within the sixty days aforesaid, shall cease to act as a reserve agent, upon thirty days' notice, to be given within the discretion of the said organization committee or of the Federal Reserve Board.

Should any national banking association in the United States now organized fail within one year after the passage of this Act to become a member bank or fail to comply with any of the provisions of this Act applicable thereto, all of the rights, privileges, and franchises of such association granted to it under the national-bank Act, or under the provisions of this Act, shall be thereby forfeited. Any noncompliance with or violation of this Act shall, however, be determined and adjudged by any court of the United States of competent jurisdiction in a suit brought for that purpose in the district or territory in which such bank is located, under

National Reserve Association Bill
(The Aldrich Bill)

The words "subscribing banks" when used hereafter in this Act shall be understood to refer to such national banks, and banks or trust companies chartered by the laws of any State of the United States or of the District of Columbia, as shall comply with the requirements for membership herein defined.

COMMENT:

The important difference here is that national banks *may* become members under the National Reserve Association Bill; while under the Federal Reserve Act they *must* become members.

Under both plans, state banks and trust companies *may*

Federal Reserve Act

direction of the Federal Reserve Board, by the Comptroller of the Currency in his own name before the association shall be declared dissolved. In cases of such noncompliance or violation, other than the failure to become a member bank under the provisions of this Act, every director who participated in or assented to the same shall be held liable in his personal or individual capacity for all damages which said bank, its shareholders, or any other person shall have sustained in consequence of such violation.

Such dissolution shall not take away or impair any remedy against such corporation, its stockholders or officers, for any liability or penalty which shall have been previously incurred.

. . .

SEC. 1. **Wherever the word "bank" is used in this Act, the word shall be held to include State bank, banking association, and trust company,**

except where national banks or Federal reserve banks are specifically referred to.

The terms "national bank" and "national banking association" used in this Act shall be held to be synonymous and interchangeable.

The term "member bank" shall be held to mean any national bank, State bank, or bank or trust company which has become a member

of one of the reserve banks created by this Act. The term "board" shall be held to mean Federal Reserve Board; the term "district" shall be held to mean Federal reserve district; the term "reserve bank" shall be held to mean Federal reserve bank.

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become members, provided they agree to conditions which differ in details, but in both cases stipulate that the applying banks are to submit to the same reserve requirements as national banks, to requirements of examinations and reports, etc.

National Reserve Association Bill
(The Aldrich Bill)

ORGANIZATION

SEC. 4. **The Secretary of the Treasury, the Secretary of Agriculture,**

the Secretary of Commerce and Labor,

and the Comptroller of the Currency

are hereby designated

a committee to effect the organization

of the National Reserve Association, and the necessary expenses of said committee shall be payable out of the Treasury upon vouchers approved by the members of said committee, and the Treasury shall be reimbursed by the National Reserve Association to the full amount paid out therefor.

Within sixty days after the passage of this Act said committee shall provide for the opening of books for subscriptions to the capital stock of said National Reserve Association in such places as the said committee may designate. Before the subscription of any bank to the capital stock of the National Reserve Asso-

Federal Reserve Act

ORGANIZATION

SEC. 2. As soon as practicable,

the Secretary of the Treasury, the Secretary of Agriculture and the Comptroller of the Currency, acting as "the Reserve Bank Organization Committee,"

shall designate not less than eight nor more than twelve cities to be known as Federal reserve cities, and shall divide the continental United States, excluding Alaska, into districts, each district to contain only one of such Federal reserve cities. The determination of said organization committee shall not be subject to review except by the Federal Reserve Board when organized: *Provided*,

ciation shall be accepted, said bank shall file with the organization committee or after organization with the National Reserve Association a certified copy of a resolution adopted by the board of directors of said bank accepting all the provisions and liabilities imposed by this Act and authorizing the president or cashier of said bank to subscribe for said stock.

SEC. 5. When the subscriptions to the capital stock of the National Reserve Association shall amount to the sum of two hundred million dollars the organization committee hereinbefore provided shall forthwith proceed to select fifteen cities in the United States for the location of the branches of said National Reserve Association: *Provided*, That one branch shall be located in the New England States, including the States of Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, and Connecticut; two branches in the Eastern States, including the States of New York, New Jersey, Pennsylvania, and Delaware; four branches in the Southern States, including the States of Maryland, Virginia, West Virginia, North Carolina, South Carolina, Georgia, Florida, Alabama, Mississippi, Louisiana, Texas, Arkansas, Kentucky, Tennessee, and also the District of Columbia; four branches in the Middle Western States, including the States of Ohio, Indiana, Illinois, Michigan, Wisconsin, Minnesota, Iowa, and Missouri; four branches in the Western and Pacific States, including the States of North Dakota, South Dakota, Nebraska, Kansas, Montana, Wyoming, Colorado, New Mexico, Oklahoma, Washington, Oregon, California, Idaho, Utah, Nevada, and Arizona.

When the cities in which the branches are to be located have been selected the organization committee shall forthwith divide

Federal Reserve Act

the entire country into fifteen districts, with one branch of the National Reserve Association in each district: *Provided*,

> **that the districts shall be apportioned with due regard to the convenient and customary course of business and not necessarily along State lines.**
>
> **The districts may be readjusted, and new districts and new branches may from time to time be created by the directors of the National Reserve Association**

whenever, in their opinion, the business of the country requires.

Federal Reserve Act

that the districts shall be apportioned with due regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States. The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board, not to exceed twelve in all.

Such districts shall be known as Federal reserve districts and may be designated by number. A majority of the organization committee shall constitute a quorum with authority to act.

Said organization committee shall be authorized to employ counsel and expert aid, to take testimony, to send for persons and papers, to administer oaths, and to make such investigation as may be deemed necessary by the said committee in determining the reserve districts and in designating the cities within such districts where such Federal reserve banks shall be severally located. The said committee shall supervise the organization in each of the cities designated of a Federal reserve bank, which shall include in its title the name of the city in which it is situated, as "Federal Reserve Bank of Chicago." . . .

Should the subscriptions by banks to the stock of said Federal reserve banks or any one or more of them be, in the judgment of the organization committee, insufficient to provide the amount

National Reserve Association Bill
(*The Aldrich Bill*)

Federal Reserve Act

of capital required therefor, then and in that event the said organization committee may, under conditions and regulations to be prescribed by it, offer to public subscription at par such an amount of stock in said Federal reserve banks, or any one or more of them, as said committee shall determine, subject to the same conditions as to payment and stock liability as provided for member banks.

No individual, copartnership, or corporation other than a member bank of its district shall be permitted to subscribe for or to hold at any time more than $25,000 par value of stock in any Federal reserve bank. Such stock shall be known as public stock and may be transferred on the books of the Federal reserve bank by the chairman of the board of directors of such bank.

Should the total subscriptions by banks and the public to the stock of said Federal reserve banks, or any one or more of them, be, in the judgment of the organization committee, insufficient to provide the amount of capital required therefor, then and in that event the said organization committee shall allot to the United States such an amount of said stock as said committee shall determine. Said United States stock shall be paid for at par out of any money in the Treasury not otherwise appropriated, and shall be held by the Secretary of the Treasury and disposed of for the benefit of the United States in such manner, at such times, and at such price, not less than par, as the Secretary of the Treasury shall determine.

Stock not held by member banks shall not be entitled to voting power.

The Federal Reserve Board is hereby empowered to adopt and promulgate rules and regulations governing the transfers of said stock.

National Reserve Association Bill
(The Aldrich Bill)

Federal Reserve Act

. . . The organization of reserve districts and Federal reserve cities shall not be construed as changing the present status of reserve cities and central reserve cities, except in so far as this Act changes the amount of reserves that may be carried with approved reserve agents located therein. The organization committee shall have power to appoint such assistants and incur such expenses in carrying out the provisions of this Act as it shall deem necessary, and such expenses shall be payable by the Treasurer of the United States upon voucher approved by the Secretary of the Treasury, and the sum of $100,000, or so much thereof as may be necessary, is hereby appropriated, out of any moneys in the Treasury not otherwise appropriated, for the payment of such expenses.

SEC. 4. . . . When the minimum amount of capital stock prescribed by this Act for the organization of any Federal reserve bank shall have been subscribed and allotted, the organization committee shall designate any five banks of those whose applications have been received, to execute a certificate of organization, and thereupon the banks so designated shall, under their seals, make an organization certificate which shall specifically state the name of such Federal reserve bank, the territorial extent of the district over which the operations of such Federal reserve bank are to be carried on, the city and State in which said bank is to be located, the amount of capital stock and the number of shares into which the same is divided, the name and place of doing business of each bank executing such certificate, and of all banks which have subscribed to the capital stock of such Federal reserve bank and the number of shares subscribed by each, and the fact

National Reserve Association Bill
(The Aldrich Bill)

COMMENT:

The Organization Committee is practically the same in both the Aldrich Bill and the Act, except that the National Reserve Association Bill provides for the designation of the Secretary of the Treasury, the Secretary of Agriculture, the Secretary of Commerce and Labor, and the Comptroller of the Currency, whereas the Federal Reserve Act designates the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency.

The National Reserve Association Bill provides for *fifteen* districts. The Federal Reserve Act provides for not less than *eight* nor more than *twelve* districts.

Federal Reserve Act

that the certificate is made to enable those banks executing same, and all banks which have subscribed or may thereafter subscribe to the capital stock of such Federal reserve bank, to avail themselves of the advantages of this Act.

The said organization certificate shall be acknowledged before a judge of some court of record or notary public; and shall be, together with the acknowledgment thereof, authenticated by the seal of such court, or notary, transmitted to the Comptroller of the Currency, who shall file, record and carefully preserve the same in his office.

In both cases, the "districts shall be apportioned with due regard to the convenient and customary course of business and not necessarily along State lines." In both cases, the "districts may be readjusted and new districts and new branches may from time to time be created."

The National Reserve Association Bill provides for the organization of local associations (mention of which is omitted here, but is made on pages 364 to 367).

The Federal Reserve Act provides for the Treasury to take over shares in Federal reserve districts where the minimum of $4,000,000 is not subscribed.

National Reserve Association Bill
(The Aldrich Bill)

ELECTION OF BOARDS OF DIRECTORS AND OFFICERS

SEC. 8. Each of the branches of the National Reserve Association shall have a board of directors, the number, not less than twelve in addition to the ex officio member, to be fixed by the by-laws of the branch. These directors shall be elected in the following manner:

The board of directors of each local association shall elect by ballot a voting representative. One-half of the elected directors of the branch shall be elected by the vote of such representatives, each representative having one vote for each of the positions to be filled, without reference to the number of shares which the banks composing the association which he represents holds in the National Reserve Association. One-third of the elected directors shall be elected by the same voting representatives, but each voting representative in this case shall have a number of votes equal to the number of shares in the National Reserve Association held by all the banks composing the local association which he represents. The remaining one-sixth of the directors shall be chosen by the directors already elected and

> **shall fairly represent the agricultural, commercial, industrial, and other interests of the district and shall not be officers nor, while serving, directors of banks, trust companies,**

Federal Reserve Act

ELECTION OF BOARDS OF DIRECTORS AND OFFICERS

SEC. 4. . . . Every Federal reserve bank shall be conducted under the supervision and control of a board of directors.

The board of directors shall perform the duties usually appertaining to the office of directors of banking associations and all such duties as are prescribed by law.

Such board of directors shall be selected as hereinafter specified and shall consist of nine members,

holding office for three years,

and divided into three classes, designated as classes A, B, and C.

Class A shall consist of three members, who shall be chosen by and be representative of the stock-holding banks.

Class B shall consist of three members, who at the time of their election

shall be actively engaged in their district in commerce, agriculture or some other industrial pursuit.

insurance companies, or other financial institutions. The manager of the branch shall be ex officio a member of the board of directors of the branch and shall be chairman of the board.

Each director shall take an oath that he will, so far as the duty devolves upon him, diligently and honestly administer the affairs of such association and will not knowingly violate or willingly permit to be violated any of the provisions of this Act.

All the members of the board of directors of the branch except the ex officio member shall at the first meeting of the board be divided into three classes. One-third of the directors shall hold office until the first Tuesday in March immediately following the election; one-third of the directors shall hold office for an additional period of one year after the first Tuesday in March immediately following the election; the remaining one-third of the directors shall hold office for an additional period of two years after the first Tuesday in March immediately following the election. All elections shall be held on the first Tuesday in March of each year, and after the first election all directors

Federal Reserve Act

Class C shall consist of three members who shall be designated by the Federal Reserve Board. When the necessary subscriptions to the capital stock have been obtained for the organization of any Federal reserve bank, the Federal Reserve Board shall appoint the class C directors and shall designate one of such directors as chairman of the board to be selected. Pending the designation of such chairman, the organization committee shall exercise the powers and duties appertaining to the office of chairman in the organization of such Federal reserve bank.

No director of class B shall be an

officer, director, or employee of any bank.

No director of class C shall be an

officer, director, employee,

or stockholder of any bank.

Directors of class A and class B shall be chosen in the following manner:

The chairman of the board of directors of the Federal reserve bank of the district in which the bank is situated or, pending the appointment of such chairman, the organization committee shall classify the member banks of the district into three general groups or divisions. Each group shall contain as nearly as may be one-third of the aggregate number of the member banks of the district and shall consist, as nearly as may be, of banks of similar capitalization. The groups shall be designated by number by the chairman.

National Reserve Association Bill
(The Aldrich Bill)

Federal Reserve Act

At a regularly called meeting of the board of directors of each member bank in the district it shall elect by ballot a district reserve elector and shall certify his name to the chairman of the board of directors of the Federal reserve bank of the district. The chairman shall make lists of the district reserve electors thus named by banks in each of the aforesaid three groups and shall transmit one list to each elector in each group.

Each member bank shall be permitted to nominate to the chairman one candidate for director of class A and one candidate for director of class B. The candidates so nominated shall be listed by the chairman, indicating by whom nominated, and a copy of said list shall, within fifteen days after its completion, be furnished by the chairman to each elector.

Every elector shall, within fifteen days after the receipt of the said list, certify to the chairman his first, second, and other choices of a director of class A and class B, respectively, upon a preferential ballot, on a form furnished by the chairman of the board of directors of the Federal reserve bank of the district. Each elector shall make a cross opposite the name of the first, second, and other choices for a director of class A and for a director of class B, but shall not vote more than one choice for any one candidate.

Any candidate having a majority of all votes cast in the column of first choice shall be declared elected. If no candidate have a majority of all the votes in the first column, then there shall be added together the votes cast by the electors for such candidates in the second column and the votes cast for the several candidates in the first column. If any candidate then have a majority of

National Reserve Association Bill
(The Aldrich Bill)

Federal Reserve Act

the electors voting, by adding together the first and second choices, he shall be declared elected. If no candidate have a majority of electors voting when the first and second choices shall have been added, then the votes cast in the third column for other choices shall be added together in like manner, and the candidate then having the highest number of votes shall be declared elected. An immediate report of election shall be declared.

Class C directors shall be appointed by the Federal Reserve Board. They shall have been for at least two years residents of the district for which they are appointed, one of whom shall be designated by said board as chairman of the board of directors of the Federal reserve bank and as "Federal reserve agent." He shall be a person of tested banking experience; and in addition to his duties as chairman of the board of directors of the Federal reserve bank he shall be required to maintain under regulations to be established by the Federal Reserve Board a local office of said board on the premises of the Federal reserve bank. He shall make regular reports to the Federal Reserve Board, and shall act as its official representative for the performance of the functions conferred upon it by this Act. He shall receive an annual compensation to be fixed by the Federal Reserve Board and paid monthly by the Federal reserve bank to which he is designated. One of the directors of class C, who shall be a person of tested banking experience, shall be appointed by the Federal Reserve Board as deputy chairman and deputy Federal reserve agent to exercise the powers of the chairman of the board and Federal reserve agent in case of absence or disability of his principal.

Directors of Federal reserve banks shall receive, in addition to any compensation otherwise provided, a reasonable allowance for

National Reserve Association Bill
(The Aldrich Bill)

shall be elected for a term of three years:

Provided, That the by-laws of the National Reserve Association shall provide for the manner of filling any vacancies which may occur in the board of directors of the branches.

The board of directors of the branch shall have authority to make by-laws, not inconsistent with law, which shall be subject to the approval of the National Reserve Association.

Federal Reserve Act

necessary expenses in attending meetings of their respective boards, which amount shall be paid by the respective Federal reserve banks. Any compensation that may be provided by boards of directors of Federal reserve banks for directors, officers or employees shall be subject to the approval of the Federal Reserve Board.

The Reserve Bank Organization Committee may, in organizing Federal reserve banks, call such meetings of bank directors in the several districts as may be necessary to carry out the purposes of this Act, and may exercise the functions herein conferred upon the chairman of the board of directors of each Federal reserve bank pending the complete organization of such bank.

At the first meeting of the full board of directors of each Federal reserve bank, it shall be the duty of the directors of classes A, B and C, respectively, to designate one of the members of each class whose term of office shall expire in one year from the first of January nearest to date of such meeting, one whose term of office shall expire at the end of two years from said date, and one whose term of office shall expire at the end of three years from said date. Thereafter every director of a Federal reserve bank chosen as hereinbefore provided shall hold office for a term of three years. Vacancies that may occur in the several classes of directors of Federal reserve banks may be filled in the manner provided for the original selection of such directors, such appointees to hold office for the unexpired terms of their predecessors.

National Reserve Association Bill
(The Aldrich Bill)

SEC. 16. Each branch shall have a manager and a deputy manager appointed from the district by the governor of the National Reserve Association with the approval of the executive committee of said association and the board of directors of the branch, and subject to removal at any time by the governor with the approval of the executive committee of the National Reserve Association. The powers and duties of the manager and deputy manager and of the various committees of the branches shall be prescribed by the by-laws of the National Reserve Association.

COMMENT:

In this comparison, the 15 branches and their directorates and officers are being compared with the 12 Federal reserve banks, their directorates, and officers.

Both systems of election recognize the difficulty that by simply giving each member bank an equal vote the small banks would secure entire control.

The Federal Reserve Act, therefore, divides the banks into three groups "which shall consist as nearly as may be, of banks of similar capitalization" and vests in each group the right to elect two directors, that is a total of six, out of nine: these six are the Class "A" and "B" directors. Three of these are to be "actively engaged in commerce, agriculture or some other industrial pursuit." The votes being cast through

Federal Reserve Act

"electors." Three additional directors, Class "C" directors, are appointed by the Federal Reserve Board.

The National Reserve Association Bill permits half of the board to be elected by numbers—each bank having one vote—; one-third of the directors is to be elected by votes equal to the number of shares held by banks in the National Reserve Association, the votes in both cases being cast through "voting representatives" of the local association; one-sixth is to be elected by the directors elected, and this one-sixth is to represent the agricultural, industrial, and other interests of the district.

National Reserve Association Bill
(The Aldrich Bill)

In both cases, directors serve for three years, and are divided into three classes.

In both cases, there are stipulations for certain directors not being permitted to be officers, directors, or employees of banks. The National Reserve Association Bill includes also "insurance companies and financial institutions." On the other hand, the Federal Reserve Act precludes Class "C" directors from being "stockholders" of banks.

The main difference is that under the National Reserve Association Bill the member banks, directly and indirectly, elect the branch board; while the Federal Reserve Act provides that one-third, of a board of nine, be appointed, as Class "C" directors, by the Federal Reserve Board.

In the National Reserve Association Bill, the manager becomes an *ex officio* member of the board, and its chairman.

The Federal Reserve Act creates the office of the Federal reserve agent, appointed by the Federal Reserve Board to act as chairman; officers, including the bank manager (governor),

Federal Reserve Act

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are to be appointed by the directors, Class "A," "B," and "C" directors acting together.

The National Reserve Association Bill leaves the appointment of the "Manager of the Branch" to the governor at the head office of the National Reserve Association in Washington with approval of his executive committee *and the board of directors of the respective branch.* (The governor and executive committee have the power of removal.)

The Federal Reserve Act seeks to accomplish the same end by letting the board of directors of the Federal reserve bank appoint the manager (governor) of the bank, the Board having the power of removal and of approving his salary; but, instead of joining in the selection of the manager (governor), the Board appoints the chairman of the board, the Federal reserve agent; in other words, instead of a joint selection of one responsible head, there is a joint administration by a dual leadership separately appointed by the central office and the local bank (which in practical operation has proved very awkward).

National Reserve Association Bill
(The Aldrich Bill)

CONSTITUTION OF THE CENTRAL BOARD

SEC. 9. The National Reserve Association shall have a board of directors, to be chosen in the following manner:

First. Fifteen directors shall be elected, one by the board of directors of each branch of the National Reserve Association. In case the number of districts shall be increased hereafter, each additional district shall be entitled to elect an additional director of this class.

Second. Fifteen additional directors shall be elected, one by the board of directors of each branch of the National Reserve Association, who shall fairly represent the

agricultural, commercial, industrial, and other interests

of the district, and who shall not be officers nor, while serving, directors of banks, trust companies, insurance companies, or other financial institutions. In case the number of districts shall be increased hereafter, each additional district shall be entitled to elect an additional director of this class.

Third. Nine additional directors shall be elected by voting representatives chosen by the boards of directors of the various branches, each of whom shall cast a number of votes equal to the number of shares in the National Reserve Association held by the banks in the branch which he represents. Not more than one of the directors of this class shall be chosen from one district.

Federal Reserve Act

CONSTITUTION OF THE CENTRAL BOARD

SEC. 10. A Federal Reserve Board is hereby created which shall consist of seven members, including the Secretary of the Treasury and the Comptroller of the Currency, who shall be members ex officio, and five members appointed by the President of the United States, by and with the advice and consent of the Senate. In selecting the five appointive members of the Federal Reserve Board, not more than one of whom shall be selected from any one Federal reserve district, the President shall have due regard to a fair representation of the different

commercial, industrial and geographical divisions of the country.

The five members of the Federal Reserve Board appointed by the President and confirmed as aforesaid shall devote their entire time to the business of the Federal Reserve Board and shall each receive an annual salary of $12,000, payable monthly together with actual necessary traveling expenses, and the Comptroller of the Currency, as ex officio member of the Federal Reserve Board, shall, in addition to the salary now paid him as Comptroller of the Currency, receive the sum of $7,000 annually for his services as a member of said Board.

The members of said board, the Secretary of the Treasury, the Assistant Secretaries of the Treasury, and the Comptroller of the Currency shall be ineligible during the time they are in office and

National Reserve Association Bill
(The Aldrich Bill)

Directors of each of the three classes named above shall be residents of the district from which they are elected.

Fourth. There shall be seven ex officio members of the board of directors, namely: The governor of the National Reserve Association, who shall be chairman of the board, two deputy governors of the National Reserve Association, the Secretary of the Treasury, the Secretary of Agriculture, the Secretary of Commerce and Labor, and the Comptroller of the Currency.

No member of any national or State legislative body shall be a director of the National Reserve Association, nor of any of its branches, nor of any local association.

All the members of the board, except the ex officio members, shall at the first meeting of the board be divided into three classes. One-third of the directors shall hold office until the first Tuesday in April immediately following the election; one-third of the directors shall hold office for an additional period of one year after the first Tuesday in April immediately following the election;

Federal Reserve Act

for two years thereafter to hold any office, position, or employment in any member bank. Of the five members thus appointed by the President at least two shall be persons experienced in banking or finance. One shall be designated by the President to serve for two, one for four, one for six, one for eight, and one for ten years, and thereafter each member so appointed shall serve for a term of ten years unless sooner removed for cause by the President. Of the five persons thus appointed, one shall be designated by the President as governor and one as vice governor of the Federal Reserve Board. The governor of the Federal Reserve Board, subject to its supervision, shall be the active executive officer. The Secretary of the Treasury may assign offices in the Department of the Treasury for the use of the Federal Reserve Board. Each member of the Federal Reserve Board shall within fifteen days after notice of appointment make and subscribe to the oath of office.

Sec. 4. No Senator or Representative in Congress shall be a member of the Federal Reserve Board or an officer or a director of a Federal reserve bank.

SEC. 10. . . . The Federal Reserve Board shall have power to levy semiannually upon the Federal reserve banks, in proportion to their capital stock and surplus, an assessment sufficient to pay its estimated expenses and the salaries of its members and employees for the half year succeeding the levying of such assessment, together with any deficit carried forward from the preceding half year.

the remaining one-third of the directors shall hold office for an additional period of two years after the first Tuesday in April immediately following the election. All elections shall be held on the first Tuesday in April of each year, and after the first election of directors shall be elected for a term of three years: *Provided*, That all directors provided for in sections seven, eight, and nine of this Act shall serve until their successors have qualified: *And provided further*, That the by-laws of the National Reserve Association shall provide for the manner of filling any vacancies which may occur in the board of directors of the National Reserve Association.

Each director shall take an oath that he will, so far as the duty devolves upon him, diligently and honestly administer the affairs of such association and will not knowingly violate or willingly permit to be violated any of the provisions of this Act.

The board of directors of the National Reserve Association shall have authority to make by-laws, not inconsistent with law, which shall prescribe the manner in which the business of said association shall be conducted and the privileges granted to it by law exercised and enjoyed.

SEC. 10. The executive officers of the National Reserve Association shall consist of a governor, two deputy governors, a secretary, and such subordinate officers as may be provided by the by-laws. The governor of the National Reserve Association shall be selected by the President of the United States from a list of not less than three submitted to him by the board of directors of said association. The person so selected shall thereupon be appointed by the said board as governor of the National Reserve

Federal Reserve Act

The first meeting of the Federal Reserve Board shall be held in Washington, District of Columbia, as soon as may be after the passage of this Act, at a date to be fixed by the Reserve Bank Organization Committee. The Secretary of the Treasury shall be ex officio chairman of the Federal Reserve Board. No member of the Federal Reserve Board shall be an officer or director of any bank, banking institution, trust company, or Federal reserve bank nor hold stock in any bank, banking institution, or trust company; and before entering upon his duties as a member of the Federal Reserve Board he shall certify under oath to the Secretary of the Treasury that he has complied with this requirement. Whenever a vacancy shall occur, other than by expiration of term, among the five members of the Federal Reserve Board appointed by the President, as above provided, a successor shall be appointed by the President, with the advice and consent of the Senate, to fill such vacancy, and when appointed he shall hold office for the unexpired term of the member whose place he is selected to fill.

The President shall have power to fill all vacancies that may happen on the Federal Reserve Board during the recess of the Senate, by granting commissions which shall expire thirty days after the next session of the Senate convenes.

Nothing in this Act contained shall be construed as taking away any powers heretofore vested by law in the Secretary of the Treasury which relate to the supervision, management, and control of the Treasury Department and bureaus under such department, and wherever any power vested by this Act in the Federal Re-

National Reserve Association Bill
(The Aldrich Bill)

Association for a term of ten years, subject to removal for cause by a two-thirds vote of the board. There shall be two deputy governors, to be elected by the board, for a term of seven years, subject to removal for cause by a majority vote of the board. The two deputy governors first elected shall serve for terms of four years and seven years, respectively. In case of any vacancy in the office of deputy governor his successor shall be elected to fill the unexpired term. In the absence of the governor or his inability to act the deputy who is senior in point of service shall act as governor. The board of directors shall have authority to appoint such other officers as may be provided for by the by-laws.

SEC. 14. The directors of the National Reserve Association shall annually elect from their number an executive committee and such other committees as the by-laws of the National Reserve Association may provide. The executive committee shall consist of nine members, of which the governor of the National Reserve Association shall be ex officio chairman and the two deputy governors and the Comptroller of the Currency ex officio members, but not more than one of the elected members shall be chosen from any one district.

The executive committee shall have all the authority which is vested in the board of directors, except the power of nomination, appointment, and removal of the governor and deputy governors and except such as may be specifically delegated by the board to other committees or to the executive officers, or such as may be specifically reserved or retained by the board.

Federal Reserve Act

serve Board or the Federal reserve agent appears to conflict with the powers of the Secretary of the Treasury, such powers shall be exercised subject to the supervision and control of the Secretary.

National Reserve Association Bill
(The Aldrich Bill)

COMMENT:

The principle of having a board representing all sections of the country and representative of banking and of "agricultural, commercial, industrial, and other interests" and of excluding members of National or State legislatures is substantially the same in both. (Strange to say, the Federal Reserve Act originally left out "agricultural" representatives. This has now been reversed, through amendment; the stipulation requiring two members experienced in banking or finance has been stricken out and one obligatory agricultural member has been added instead.)

The main difference is that in the National Reserve Association Bill the members elect a majority of the Central Board.

In the Federal Reserve Act, the entire Board is appointed by the President.

In the National Reserve Association Bill, the directors of the National Reserve Association propose a list of three from which the President elects the governor for ten years.

In the Federal Reserve Act, the President appoints the governor and vice governor from among the five appointive members; the governor and vice governor to serve at his pleasure.

The National Reserve Association Bill provides for a board of directors of 46 members; but it also provides for an executive committee which must be considered as the working body.

Federal Reserve Act

This executive committee offers the best point of comparison with the Federal Reserve Board. Here we have:

NATIONAL RESERVE ASSOCIATION EXECUTIVE COMMITTEE

Nine Members

A. Governor, chairman
B. Two deputy governors
C. Comptroller of the Currency
D. Five directors, representatives of the member banks elected by the directors of the National Reserve Association (*of whom not more than one may be chosen from any district*)

FEDERAL RESERVE BOARD

Seven Members

A. Secretary of Treasury, chairman
B. Comptroller of the Currency
C. Five members (*appointed by the President and to be confirmed by the Senate, not more than one to be selected from any one Federal reserve district*)

It is difficult to see how the executive committee of the National Reserve Association could be charged with being dangerously exposed to the preponderance of any one single influence or control. A close examination of the constitution of the boards of directors of the local associations, the branches, and the National Reserve Association will convince the student how much exaggeration there has been in these charges.

National Reserve Association Bill
(The Aldrich Bill)

Powers of the Central Board

Sec. 29. The power of rediscount and discount granted to the National Reserve Association by sections twenty-six, twenty-seven, and twenty-eight of this Act shall in each case be exercised through the branch in the district in which the bank making the application is located.

Federal Reserve Act

Powers of the Central Board

Sec. 11. The Federal Reserve Board shall be authorized and empowered:

(a) To examine at its discretion the accounts, books and affairs of each Federal reserve bank and of each member bank and to require such statements and reports as it may deem necessary. The said board shall publish once each week a statement showing the condition of each Federal reserve bank and a consolidated statement for all Federal reserve banks. Such statements shall show in detail the assets and liabilities of the Federal reserve banks, single and combined, and shall furnish full information regarding the character of the money held as reserve and the amount, nature and maturities of the paper and other investments owned or held by Federal reserve banks.

(b) To permit, or, on the affirmative vote of at least five members of the Reserve Board to require Federal reserve banks to rediscount the discounted paper of other Federal reserve banks at rates of interest to be fixed by the Federal Reserve Board.

(c) To suspend for a period not exceeding thirty days, and from time to time to renew such suspension for periods not exceeding fifteen days, any reserve requirement specified in this Act: *Provided*, That it shall establish a graduated tax upon the amounts by which the reserve requirements of this Act may be permitted to fall below the level hereinafter specified: *And provided further*, That when the gold reserve held against Federal reserve notes falls below forty per centum, the Federal Reserve Board shall establish a graduated tax of not more than one per centum per

National Reserve Association Bill
(The Aldrich Bill)

Federal Reserve Act

annum upon such deficiency until the reserves fall to thirty-two and one-half per centum, and when said reserve falls below thirty-two and one-half per centum, a tax at the rate increasingly of not less than one and one-half per centum per annum upon each two and one-half per centum or fraction thereof that such reserve falls below thirty-two and one-half per centum. The tax shall be paid by the reserve bank, but the reserve bank shall add an amount equal to said tax to the rates of interest and discount fixed by the Federal Reserve Board.

(d) To supervise and regulate through the bureau under the charge of the Comptroller of the Currency the issue and retirement of Federal reserve notes, and to prescribe rules and regulations under which such notes may be delivered by the Comptroller to the Federal reserve agents applying therefor.

(e) To add to the number of cities classified as reserve and central reserve cities under existing law in which national banking associations are subject to the reserve requirements set forth in section twenty[1] of this Act; or to reclassify existing reserve and central reserve cities or to terminate their designation as such.

(f) To suspend or remove any officer or director of any Federal reserve bank, the cause of such removal to be forthwith communicated in writing by the Federal Reserve Board to the removed officer or director and to said bank.

(g) To require the writing off of doubtful or worthless assets upon the books and balance sheets of Federal reserve banks.

[1] This reference to Section Twenty is an error in the Act. The reference should be to Section Nineteen.—*Author.*

National Reserve Association Bill
(The Aldrich Bill)

Federal Reserve Act

(h) To suspend, for the violation of any of the provisions of this Act, the operations of any Federal reserve bank, to take possession thereof, administer the same during the period of suspension, and, when deemed advisable, to liquidate or reorganize such bank.

(i) To require bonds of Federal reserve agents, to make regulations for the safeguarding of all collateral, bonds, Federal reserve notes, money or property of any kind deposited in the hands of such agents, and said board shall perform the duties, functions, or services specified in this Act, and make all rules and regulations necessary to enable said board effectively to perform the same.

(j) To exercise general supervision over said Federal reserve banks.

(k) To grant by special permit to national banks applying therefor, when not in contravention of State or local law, the right to act as trustee, executor, administrator, or registrar of stocks and bonds under such rules and regulations as the said board may prescribe.

(l) To employ such attorneys, experts, assistants, clerks, or other employees as may be deemed necessary to conduct the business of the board. All salaries and fees shall be fixed in advance by said board and shall be paid in the same manner as the salaries of the members of said board. All such attorneys, experts, assistants, clerks, and other employees shall be appointed without regard to the provisions of the Act of January sixteenth, eighteen

National Reserve Association Bill
(The Aldrich Bill)

COMMENT:

Section 29 of the National Reserve Association Bill has been placed alongside of Section 11 of the Federal Reserve Act.

Section 11 of the Federal Reserve Act deals with the powers of the Federal Reserve Board. (Governor Hamlin, in his index, registers 127 powers and duties of the Federal Reserve Board.) There is, of course, no similar provision in the National Reserve Association Bill; but a closer study develops the far-reaching importance of Section 29 of the National Reserve Association Bill in its bearing upon the question of "similarity."

The problem in both cases is to vest supervision and a certain amount of direction in the central office in Washington, without, however, giving it the power to do the local discount business which is placed in the hands of the local directorates of the 15 branches and of the 12 Federal reserve banks respectively. For the exercise of the "power of discount and

Federal Reserve Act

hundred and eighty-three (volume twenty-two, United States Statutes at Large, page four hundred and three), and amendments thereto, or any rule or regulation made in pursuance thereof: *Provided*, That nothing herein shall prevent the President from placing said employees in the classified service.

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rediscount," these 15 or 12 directorates respectively are to act as organizations with certain autonomous powers; but the exercise of these powers is to be under the supervision of the Central Board. In other words: the Central Board or the executive committee of the National Reserve Association fixes the discount rate and the rules; the actual rediscount business is done by the 15 branches. The analogy with the operations and control of the Federal Reserve Board is clear, where the Board "determines and reviews" the discount rates and the 12 Federal reserve banks do the actual business, the Federal Reserve Board having the power to make one Federal reserve bank rediscount for the other.

Open market operations are left in the hands of the central office of the National Reserve Association, while the Federal Reserve Act places the power to carry on these operations with the Federal reserve banks, subject to the general supervision and regulation by the Board.

National Reserve Association Bill
(The Aldrich Bill)

Filing of Certificate and Call for First Payment

Sec. 11. When the National Reserve Association is duly organized its board of directors shall call upon the subscribing banks for a payment of fifty per centum on the amount of their subscriptions to the capital stock of said association. When one hundred million dollars of capital have been paid in the board of directors shall at once proceed to execute and file with the Secretary of State a certificate showing the payment of one hundred million dollars on capital stock, and they shall further file with the Comptroller of the Currency a certificate showing the title and location of each bank which has subscribed to the capital stock of the National Reserve Association, the number of shares subscribed by each, and the amount paid thereon.

Comment:

M.M.S.

Federal Reserve Act

Filing of Certificate and Call for First Payment

Sec. 4. When the organization committee shall have established Federal reserve districts as provided in section two of this Act, a certificate shall be filed with the Comptroller of the Currency showing the geographical limits of such districts and the Federal reserve city designated in each of such districts. The Comptroller of the Currency shall thereupon cause to be forwarded to each national bank located in each district, and to such other banks declared to be eligible by the organization committee which may apply therefor, an application blank in form to be approved by the organization committee, which blank shall contain a resolution to be adopted by the board of directors of each bank executing such application, authorizing a subscription to the capital stock of the Federal reserve bank organizing in that district in accordance with the provisions of this Act.

National Reserve Association Bill
(The Aldrich Bill)

STOCK SUBSCRIPTIONS AND INCREASES AND DECREASES OF HOLDINGS

SEC. 12. Shares of the capital stock of the National Reserve Association

shall not be transferable, and under no circumstances shall they be hypothecated

nor shall they be owned otherwise than by subscribing banks, nor shall they be owned by any such bank other than in the proportion herein provided. In case

a subscribing bank increases its capital it shall thereupon subscribe for an additional amount of the capital

of the National Reserve Association equal to twenty per centum of the bank's increase of capital, paying therefor its then book value as shown by the last published statement of said association.

Federal Reserve Act

STOCK SUBSCRIPTIONS AND INCREASES AND DECREASES OF HOLDINGS

SEC. 5. . . . Shares of the capital stock of Federal reserve banks owned by member banks

shall not be transferred or hypothecated. When a member bank increases its capital stock or surplus, it shall thereupon subscribe for an additional amount

of capital stock of the Federal reserve bank of its district equal to six per centum of the said increase, one-half of said subscription to be paid in the manner hereinbefore provided for original subscription, and one-half subject to call of the Federal Reserve Board.

National Reserve Association Bill
(The Aldrich Bill)

A bank applying for membership in the National Reserve Association at any time after its formation must subscribe for an amount of the capital of said association

equal to twenty per centum of the capital of said subscribing bank, paying therefor its then book value as shown by the last published statement of said association. When the capital of the National Reserve Association has been increased either on account of the increase of capital of the banks in said association or on account of the increase in the membership of said association, the board of directors shall make and execute a certificate

showing said increase in capital, the amount paid in and by whom paid.

This certificate shall be filed in the office of the Comptroller of the Currency.

In case a subscribing bank reduces its capital it shall surrender a proportionate amount of its holdings in the capital of said association, and if a bank goes into voluntary liquidation it shall surrender all of its holdings of the capital of said association.

Federal Reserve Act

A bank applying for stock in a Federal reserve bank at any time after the organization thereof must subscribe for an amount of the capital stock of the Federal reserve bank

equal to six per centum of the paid-up capital stock and surplus of said applicant bank, paying therefor its par value plus one-half of one per centum a month from the period of the last dividend. When the capital stock of any Federal reserve bank shall have been increased either on account of the increase of capital stock of member banks or on account of the increase in the number of member banks, the board of directors shall cause to be executed a certificate to the Comptroller of the Currency

showing the increase in capital stock, the amount paid in, and by whom paid. When a member bank reduces its capital stock it shall surrender a proportionate amount of its holdings in the capital of said Federal reserve bank, and when a member bank voluntarily liquidates it shall surrender all of its holdings of the capital stock of said Federal reserve bank and be released from its stock subscription

not previously called.

National Reserve Association Bill
(The Aldrich Bill)

In either case the shares surrendered shall be canceled and the bank shall receive in payment therefor

a sum equal

to their then book value as shown by the last published statement of said association.

If any member of the National Reserve Association shall become insolvent and a receiver be appointed, the stock held by it in said association shall be canceled and the balance, after paying all debts due by such insolvent bank to said association

(such debts being hereby declared to be a first lien upon the paid-in capital stock),

Federal Reserve Act

in either case the shares surrendered shall be canceled and the member bank shall receive in payment therefor,

under regulations to be prescribed by the Federal Reserve Board,

a sum equal

to its cash-paid subscriptions on the shares surrendered and one-half of one per centum a month from the period of the last dividend, not to exceed the book value thereof, less any liability of such member bank to the Federal reserve bank.

SEC. 6. **If any member bank shall be declared insolvent and a receiver appointed therefor, the stock held by it in said Federal reserve bank shall be canceled,**

without impairment of its liability, and all cash-paid subscriptions on said stock, with one-half of one per centum per month from the period of last dividend, not to exceed the book value thereof,

National Reserve Association Bill
(The Aldrich Bill)

shall be paid to the receiver of the insolvent bank.

Whenever the capital stock of the National Reserve Association is reduced, either on account of the reduction in capital of members of said association or the liquidation or insolvency of any member, the board of directors shall make and execute a certificate showing such reduction of capital stock and the amount repaid to each bank. This certificate shall be filed in the office of the Comptroller of the Currency.

COMMENT:

M.M.S.—except that in case of surrender of stock or liquidation the National Reserve Association Bill provides for the

Federal Reserve Act

shall be first applied to all debts of the insolvent member bank to the Federal reserve bank, and the balance, if any, shall be paid to the receiver of the insolvent bank. Whenever the capital stock of a Federal reserve bank is reduced, either on account of a reduction in capital stock of any member bank or of the liquidation or insolvency of such bank, the board of directors shall cause to be executed a certificate to the Comptroller of the Currency showing such reduction of capital stock and the amount repaid to such bank.

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payment of a price equivalent to the book value, while the Federal Reserve Act provides for the payment of par value plus ½ per cent per month from last date of last dividend.

National Reserve Association Bill
(The Aldrich Bill)

Tax Exemption

Sec. 13. The National Reserve Association and its branches and the local associations shall be exempt from local and State taxation except in respect to taxes upon real estate.

Comment:

Identical.

Federal Reserve Act

Tax Exemption

Sec. 7. . . . **Federal reserve banks, including the capital stock and surplus therein, and the income derived therefrom shall be exempt from Federal, State, and local taxation, except taxes upon real estate.**

National Reserve Association Bill
(The Aldrich Bill)

EXAMINATIONS

SEC. 15. There shall be a board of examination elected annually by the board of directors from among their number, excluding the members of the executive committee, of which the Secretary of the Treasury shall be ex officio chairman.

It shall be the duty of this board to carefully examine the condition and the business of the National Reserve Association and of its branches

and to make a public statement of the result of such examination

at least once a year.

COMMENT:

M.M.S.; except that results of examinations of the National Reserve Association and its branches are to be given out in a public statement; no such specific provision in the Federal Reserve Act.

Federal Reserve Act

EXAMINATIONS

SEC. 11. The Federal Reserve Board shall be authorized and empowered:

(a) To examine at its discretion the accounts, books and affairs of each Federal reserve bank and of each member bank and to require such statements and reports as it may deem necessary.

SEC. 21. The Federal Reserve Board

shall, at least once each year, order an examination of each Federal reserve bank,

and upon joint application of ten member banks the Federal Reserve Board shall order a special examination and

report of

the condition of any Federal reserve bank.

SEC. 10. The Federal Reserve Board shall annually make a full report of its operations to the Speaker of the House of Representatives, who shall cause the same to be printed for the information of the Congress.

National Reserve Association Bill
(The Aldrich Bill)

Earnings, Contingent Funds, and Government's Share in Excess Earnings

Sec. 19. The earnings of the National Reserve Association shall be disposed of in the following manner:

after the payment of all expenses

and the franchise and other taxes not provided for in this section

the shareholders shall be entitled to receive an annual dividend

of four per centum

on the paid-in capital, which dividend shall be cumulative.

Further annual net earnings shall be disposed of as follows: First, a contingent fund shall be created, which shall be maintained at an amount equal to one per centum on the paid-in capital, and shall not exceed in any event two million dollars and shall be used to meet any possible losses. Such fund shall, upon the final dissolution of the National Reserve Association, be paid to the United States and shall not under any circumstances be included in the book value of the stock or be paid to the shareholders. Second, one-half of additional net earnings shall be paid into the

Federal Reserve Act

Earnings, Contingent Funds, and Government's Share in Excess Earnings

Sec. 7. **After all necessary expenses**

of a Federal reserve bank

have been paid

or provided for,

the stockholders shall be entitled to receive an annual dividend

of six per centum

on the paid-in capital stock, which dividend shall be cumulative.

National Reserve Association Bill
(The Aldrich Bill)

surplus fund of the National Reserve Association until said fund shall amount to twenty per centum of the paid-in capital, one-fourth shall be paid to the United States

as a franchise tax,

and one-fourth shall be paid to the shareholders, until the shareholders' dividend shall amount to five per centum per annum on the paid-in capital: *Provided*, That no such dividends, exclusive of the cumulative dividends above provided for, shall at any time be paid in excess of five per centum in any one year. Whenever and so long as the contingent fund has been provided for and the five per centum dividend has been paid to shareholders one-half of the additional earnings shall be added to the surplus fund, and one-half shall be paid to the United States

as a franchise tax.

Whenever and so long as the surplus fund of the National Reserve Association amounts to twenty per centum of the paid-in capital and the shareholders shall have received dividends not exceeding five per centum,

all excess earnings shall be paid to the United States as a franchise tax.

COMMENT:

The principle in both is the same: limited earnings, creation of contingent funds, and turning over of excess to the United States Government.

The National Reserve Association Bill is more favorable to the government in these stipulations; the division of the earnings with the government begins sooner, and the divi-

Federal Reserve Act

After the aforesaid dividend claims have been fully met,

all the net earnings shall be paid to the United States as a franchise tax,

except that one-half of such net earnings shall be paid into a surplus fund until it shall amount to forty per centum of the paid-in capital stock of such bank.

The net earnings derived by the United States from Federal reserve banks shall, in the discretion of the Secretary, be used to supplement the gold reserve held against outstanding United States notes, or shall be applied to the reduction of the outstanding bonded indebtedness of the United States under regulations to be prescribed by the Secretary of the Treasury. Should a Federal reserve bank be dissolved or go into liquidation, any surplus remaining, after the payment of all debts, dividend requirements as hereinbefore provided, and the par value of the stock, shall be paid to and become the property of the United States and shall be similarly applied.

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dends are limited to 5 per cent as against 6 per cent in the Federal Reserve Act.

The Federal Reserve Act adds that the Secretary of the Treasury may use such earnings from Federal reserve banks to supplement the gold reserve behind greenbacks or to reduce the outstanding bonded indebtedness. (This was also suggested in some of my earlier articles.)

National Reserve Association Bill
(The Aldrich Bill)

Equal Advantages for all Members and Right to Suspend Members from Use of Privileges

Sec. 22. All of the privileges and advantages of the National Reserve Association shall be equitably extended to every bank of any of the classes herein defined which shall subscribe to its proportion of the capital stock of the National Reserve Association and shall otherwise conform to the requirements of this Act: *Provided,* That the National Reserve Association may

suspend a bank from the privileges of membership

for refusal to comply with such requirements or for a failure for thirty days to maintain its reserves, or to make the reports required by this Act, or for misrepresentation in any report or examination as to its condition or as to the character or extent of its assets or liabilities.

Comment:

M.M.S.

Federal Reserve Act

Equal Advantages for all Members and Right to Suspend Members from Use of Privileges

Sec. 4. . . . Said board shall administer the affairs of said bank fairly and impartially and without discrimination in favor of or against any member bank or banks and shall, subject to the provisions of law and the orders of the Federal Reserve Board, extend to each member bank such discounts, advancements and accommodations as may be safely and reasonably made with due regard for the claims and demands of other member banks. . . .

Sec. 9. If at any time it shall appear to the Federal Reserve Board that a member bank has failed to comply with the provisions of this section or the regulations of the Federal Reserve Board, it shall be within the power of the said board, after hearing, to require such bank to surrender its stock in the Federal reserve bank; upon such surrender the Federal reserve bank shall pay the cash-paid subscriptions to the said stock with interest at the rate of one-half of one per centum per month, computed from the last dividend, if earned, not to exceed the book value thereof, less any liability to said Federal reserve bank, except the subscription liability not previously called, which shall be canceled, and said Federal reserve bank shall, upon notice from the Federal Reserve Board, be required

> **to suspend said bank from further privileges of membership,**

and shall within thirty days of such notice cancel and retire its stock and make payment therefor in the manner herein provided. The Federal Reserve Board may restore membership upon due proof of compliance with the conditions imposed by this section.

National Reserve Association Bill
(The Aldrich Bill)

FISCAL AGENCY RELATIONS

SEC. 23. The National Reserve Association shall be the principal fiscal agent of the United States. The Government of the United States shall upon the organization of the National Reserve Association deposit its general funds with said association and its branches, and thereafter all receipts of the Government, exclusive of trust funds, shall be deposited with said Association and its branches, and all disbursements by the Government shall be made through said association and its branches.

COMMENT:

The National Reserve Association Bill makes it obligatory upon the Treasury to use the National Reserve Association as fiscal agent for all its free funds.

Federal Reserve Act

FISCAL AGENCY RELATIONS

SEC. 15. The moneys held in the general fund of the Treasury, except the five per centum fund for the redemption of outstanding national-bank notes and the funds provided in this Act for the redemption of Federal reserve notes may, upon the direction of the Secretary of the Treasury, be deposited in Federal reserve banks, which banks, when required by the Secretary of the Treasury, shall act as fiscal agents of the United States; and the revenues of the Government or any part thereof may be deposited in such banks, and disbursements may be made by checks drawn against such deposits.

No public funds of the Philippine Islands, or of the postal savings, or any Government funds, shall be deposited in the continental United States in any bank not belonging to the system established by this Act: *Provided, however*, That nothing in this Act shall be construed to deny the right of the Secretary of the Treasury to use member banks as depositories.

The Federal Reserve Act makes it obligatory upon Federal reserve banks to act as fiscal agents *when required* by the Secretary of the Treasury, but retains for him the fullest freedom to deposit government funds with banks and trust companies outside the System.

National Reserve Association Bill
(The Aldrich Bill)

Government and Members to be Sole Depositors

Sec. 24. **The Government of the United States and banks owning stock in the National Reserve Association shall be the only depositors in said association.**

All domestic transactions of the National Reserve Association shall be confined to the Government and the subscribing banks, with the exception of the purchase or sale of Government or State securities or securities of foreign governments or of gold coin or bullion.

(Owen Bill verbatim)

Comment:

The National Reserve Association Bill limits the domestic so-called "open-market operations" to transactions with sub-

Federal Reserve Act

GOVERNMENT AND MEMBERS TO BE SOLE DEPOSITORS

SEC. 13. Any Federal reserve bank

may receive from any of its member banks, and from the United States, deposits

of current funds in lawful money, national-bank notes, Federal reserve notes, or checks and drafts upon solvent member banks, payable upon presentation; or, solely for exchange purposes, may receive from other Federal reserve banks deposits of current funds in lawful money, national-bank notes, or checks and drafts upon solvent member or other Federal reserve banks, payable upon presentation.

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scribing banks, except transactions in government or State bonds or foreign government securities or gold coin or bullion.

The Federal Reserve Act goes further in certain respects; we shall revert to this under Sections 31–36.

National Reserve Association Bill
(The Aldrich Bill)

INTEREST ON RESERVE BALANCES

SEC. 25. The National Reserve Association shall pay no interest on deposits.

(Owen Bill verbatim)

COMMENT:

In the Federal Reserve Act, there is neither any inhibition to pay interest on balances, nor a mandatory provision that

Federal Reserve Act

INTEREST ON RESERVE BALANCES

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interest shall be paid. As a matter of fact, interest has never been paid nor—it is to be hoped—ever will be. To pay interest on reserve money, the major part of which should normally be kept idle, would destroy the safety of the System.

National Reserve Association Bill
(The Aldrich Bill)

REDISCOUNT POWERS

SEC. 26. The National Reserve Association may through a branch rediscount for and

with the indorsement of any bank having a deposit with it, notes and bills of exchange arising out of commercial transactions; that is, notes and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, and not including notes or bills issued or drawn for the purpose of carrying stocks, bonds, or other investment securities.

Federal Reserve Act

Rediscount Powers

Powers of Federal Reserve Banks

Sec. 13. . . . **Upon the indorsement of any of its member banks,**

with a waiver of demand, notice and protest by such bank, any Federal reserve bank may discount

notes, drafts, and bills of exchange arising out of

actual

commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes,

or the proceeds of which have been used, or are to be used, for such purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act. Nothing in this Act contained shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise from being eligible for such discount; but such definition

shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying

or trading in

stocks, bonds, or other investment securities,

Such notes and bills must have a maturity of not more than twenty-eight days, and must have been made at least thirty days prior to the date of rediscount. The amount so rediscounted shall at no time exceed the capital of the bank for which the rediscounts are made.

The aggregate of such notes and bills bearing the signature or indorsement of any one person, company, firm, or corporation, rediscounted for any one bank, shall at no time exceed ten per centum of the unimpaired capital and surplus of said bank.

SEC. 27. The National Reserve Association may through a branch also rediscount, for and with the indorsement of any bank having a deposit with it, notes and bills of exchange arising out of commercial transactions as hereinbefore defined, having more than twenty-eight days, but not exceeding four months, to run, but in such cases the paper must be guaranteed by the local association of which the bank asking for the rediscount is a member.

SEC. 28. Whenever, in the opinion of the governor of the National Reserve Association, the public interests so require, such opinion to be concurred in by the executive committee of the National Reserve Association and to have the definite approval of the Secretary of the Treasury, the National Reserve Associa-

Federal Reserve Act

except bonds and notes of the Government of the United States. Notes, drafts, and bills admitted to discount under the terms of this paragraph must have a maturity at the time of discount of not more than ninety days: *Provided*, That notes, drafts, and bills drawn or issued for agricultural purposes or based on live stock and having a maturity not exceeding six months may be discounted in an amount to be limited to a percentage of the capital of the Federal reserve bank, to be ascertained and fixed by the Federal Reserve Board. . . .

The aggregate of such notes and bills bearing the signature or indorsement of any one person, company, firm, or corporation rediscounted for any one bank shall at no time exceed ten per centum of the unimpaired capital and surplus of said bank;

but this restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values.

National Reserve Association Bill
(The Aldrich Bill)

tion may through a branch discount the direct obligation of a depositing bank, indorsed by its local association, provided that the indorsement of the local association shall be fully secured by the pledge and deposit with it of satisfactory securities, which shall be held by the local association for account of the National Reserve Association; but in no such case shall the amount loaned by the National Reserve Association exceed three-fourths of the actual value of the securities so pledged.

COMMENT:

The difference between the two sections consists in the precaution contained in the National Reserve Association Bill, that paper with a maturity in excess of 28 days must bear the signature of the local association.

Eliminate this restriction, and the respective sections of the two acts are practically identical.

It may be interesting to note that at the date of this writing (February, 1927) the total "bills discounted" (Federal Reserve Bulletin, February, 1927) amounted to $416,059,000; of these $310,773,000 matured within 15 days and additional $27,613,000 matured within 16 to 30 days. Of the bills bought in the open market—totaling $337,360,000—$218,171,000 were maturing within 30 days.

At the close of 1928 (December 26) of the total of $1,167,579,000 of discounted bills held by the Federal reserve banks $1,012,581,000 matured within 15 days and additional $38,749,000 within 16 to 30 days.

Federal Reserve Act

Federal reserve bank holdings of bills bought in the open market amounted at the close of 1928 to $489,270,000. Of this total $259,346,000 were maturing within 30 days.

The Federal Reserve Act contains some exceptions in favor of agricultural paper and in favor of bills drawn against United States Government bonds.

The National Reserve Association provides for the discount of bills drawn against government securities in Section 28, which in addition contains broader (emergency) powers to discount paper "secured by securities." A similar section was contained in the first drafts of the Federal Reserve Act, but later on was stricken out.

The early drafts of the Federal Reserve Act also contained provisions favoring paper of short maturity. The rediscount operations under Sections 26, 27, and 28 may only be carried out through the branches of the National Reserve Association; this corresponds to the rediscounting powers given to the Federal reserve banks under the Federal Reserve Act.

National Reserve Association Bill
(The Aldrich Bill)

FIXING OF DISCOUNT RATES

SEC. 30. The National Reserve Association shall have authority to fix its rates of discount from time to time, which when so fixed shall be published, and shall be uniform throughout the United States.

COMMENT:

The National Reserve Association Bill provides for uniform discount rates throughout the United States.

The Federal Reserve Act provides for discount rates that may differ between Federal reserve districts.

Discount rates that may differ between districts, no doubt, are preferable. The United Reserve Bank Plan provided for the possibility of varying rates; Senator Aldrich hoped that the uniform rate would prove a strong factor in overcoming resistance to the bill.

The National Reserve Association Bill stipulates that the Board in Washington shall fix the rate of discount.

The Federal Reserve Act provides that the Federal reserve banks shall establish the rates "subject to review and determination of the Federal Reserve Board."[2]

Federal Reserve Act

FIXING OF DISCOUNT RATES

SEC. 14. . . . Every Federal reserve bank shall have power: . . .

(d) To establish from time to time, subject to review and determination of the Federal Reserve Board, rates of discount to be charged by the Federal reserve bank for each class of paper, which shall be fixed with a view of accommodating commerce and business; . . .

The provision in the Federal Reserve Act dividing the authority of rate fixing has proved very difficult in operation. While, in theory, the initiative rests with 12 autonomous Federal reserve banks, in practice the Board must assume a great deal of leadership in order to bring about a national and coordinated policy.

The Executive Committee of the National Reserve Association, in spite of its power to fix the rate, would no doubt have acted only after full consultation with the 15 branches, and similarly the 12 Federal reserve banks converge at Washington, and the Board, while respecting to the utmost the autonomy of the Federal reserve banks must, in the end, after due consultation, determine the national policy. See Addendum I, Vol. I.

National Reserve Association Bill
(The Aldrich Bill)

POWER FOR NATIONAL BANKS TO MAKE "ACCEPTANCES"

SEC. 31. National banks are

hereby authorized to accept drafts or bills of exchange drawn upon them, having not more than
four
months to run,

properly secured, and arising out of commercial transactions as hereinbefore defined.

The amount of such acceptances outstanding shall not exceed one-half the capital and surplus of the accepting bank,

and shall be subject to the restrictions of section fifty-two hundred of the Revised Statutes.

Federal Reserve Act

POWER FOR NATIONAL BANKS TO MAKE "ACCEPTANCES"

SEC. 13. . . . Any member bank

may accept drafts or bills of exchange drawn upon it

and growing out of transactions involving the importation or exportation of goods

having not more than

six

months sight to run;

but no bank shall

accept such bills to an amount equal at any time in the aggregate to more than one-half its paid-up capital stock and surplus.

Section fifty-two hundred and two of the Revised Statutes of the United States is hereby amended so as to read as follows: No national banking association shall at any time be indebted, or in any way liable, to an amount exceeding the amount of its capital stock at such time actually paid in and remaining undiminished by losses or otherwise, except on account of demands of the nature following:

First. Notes of circulation.

Second. Moneys deposited with or collected by the association.

Third. Bills of exchange or drafts drawn against money actually on deposit to the credit of the association, or due thereto.

National Reserve Association Bill
(The Aldrich Bill)

COMMENT:

The respective clauses are identical except that the National Reserve Association Bill authorizes acceptances to be drawn for "commercial transactions as heretofore defined," while the Federal Reserve Act restricts the power to accept to "transactions involving importations and exportations" (later widened by amendment to include certain domestic transactions and finance drafts); and that the National Reserve Association stipulates that acceptances shall have not more than four months to run and shall be "properly secured," while the

Federal Reserve Act

Fourth. Liabilities to the stockholders of the association for dividends and reserve profits.

Fifth. Liabilities incurred under the provisions of the Federal Reserve Act.

The rediscount by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by this Act, shall be subject to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board.

Federal Reserve Act stipulates not more than six months sight and does not provide for "properly secured."

Exception "Fifth" in the Federal Reserve Act is queer and anomalous. Its effect is that if a member bank sells acceptances with its endorsement in the bill market, such endorsement must be treated as a liability; if it endorses the same bills to the Federal reserve bank, it is not so to be counted. In other words, this provision designedly places a handicap on the development of an open discount market.

National Reserve Association Bill
(The Aldrich Bill)

POWER TO PURCHASE (OR DISCOUNT) ACCEPTANCES

SEC. 32. The National Reserve Association may, whenever its own condition and the general financial conditions warrant such investment, purchase from a subscribing bank

acceptances

of banks or acceptors of unquestioned financial responsibility arising out of commercial transactions as hereinbefore defined.

Such acceptances must have not exceeding ninety days to run,

and must be of a character generally known in the market as prime bills.

Such acceptances shall bear the indorsement of the subscribing bank

selling the same, which indorsement must be other than that of the acceptor.

COMMENT:

The respective clauses are very similar except for some added limitations in the Federal Reserve Act.

The provision in the Federal Reserve Act definitely limiting the amount of acceptances discounted for any one member to one-half of the paid-up capital and surplus of that member is entirely incomprehensible, if the framers of the Act honestly desired to create a discount market to take the place of the call loan market on the New York Stock Exchange. Instead of

Federal Reserve Act

POWER TO PURCHASE (OR DISCOUNT) ACCEPTANCES

SEC. 13. . . . Any Federal reserve bank may discount

acceptances

which are based on the importation or exportation of goods and

which have a maturity at time of discount of not more than three months, and indorsed by at least one member bank.

The amount of acceptances so discounted shall at no time exceed one-half the paid-up capital stock and surplus of the bank for which the rediscounts are made.

The aggregate of such notes and bills bearing the signature or indorsement of any one person, company, firm, or corporation rediscounted for any one bank shall at no time exceed ten per centum of the unimpaired capital and surplus of said bank; but this restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values.

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encouraging members to buy acceptances in large amounts and to treat them as their secondary reserves, this restriction was bound to have the opposite effect. (This provision was later on modified by amendment.) The tendency evidenced in this clause is all the harder to explain when one considers it in connection with the open market powers conferred in Section 14 of the Federal Reserve Act to which we shall revert in the chapter dealing with open-market purchases.

National Reserve Association Bill
(The Aldrich Bill)

INVESTMENTS IN UNITED STATES BONDS AND OTHER SECURITIES

SEC. 33. The National Reserve Association may invest in

United States bonds; also in obligations, having not more than one year to run, of the United States or its dependencies, or of any State,

or of foreign governments.

(Verbatim Owen Bill)

COMMENT:

M.M.S.—except that the National Reserve Association Bill provides for power to invest also in short time obligations of

Federal Reserve Act

INVESTMENTS IN UNITED STATES BONDS AND OTHER SECURITIES

SEC. 14. . . . Every Federal reserve bank shall have power: . . .
(b) To buy and sell, at home or abroad, bonds and notes of the

United States, and bills, notes, revenue bonds,

and warrants with a maturity from date of purchase of not exceeding six months, issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues by any State, county, district, political subdivision, or municipality in the continental United States, including irrigation, drainage and reclamation districts, such purchases to be made in accordance with rules and regulations prescribed by the Federal Reserve Board; . . .

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foreign governments. On the other hand, the Federal Reserve Act gives wider latitude with regard to the purchase of obligations issued by counties, municipalities, etc.

National Reserve Association Bill
(The Aldrich Bill)

Power to Deal in Gold and Bullion

Sec. 34. **The National Reserve Association shall have power, both at home and abroad, to deal in gold coin or bullion, to make loans thereon, and to contract for loans of gold coin or bullion, giving therefor, when necessary, acceptable security, including the hypothecation of any of its holdings of United States bonds.**

Comment:
M.M.S.

Federal Reserve Act

Power to Deal in Gold and Bullion

Sec. 14. . . . Every Federal reserve bank shall have power:

(a) **To deal in gold coin and bullion at home or abroad, to make loans thereon, exchange Federal reserve notes for gold, gold coin, or gold certificates, and to contract for loans of gold coin or bullion, giving therefor,when necessary, acceptable security, including the hypothecation of United States bonds**

or other securities which Federal reserve banks are authorized to hold;

National Reserve Association Bill
(The Aldrich Bill)

OPEN-MARKET PURCHASES

SEC. 35. The National Reserve Association shall have power to purchase from its subscribing banks and to sell, with or without its indorsement, checks or bills of exchange, arising out of commercial transactions as hereinbefore defined, payable in such foreign countries as the board of directors of the National Reserve Association may determine. These bills of exchange must have not exceeding ninety days to run, and must bear the signatures of two or more responsible parties, of which the last one shall be that of a subscribing bank.

COMMENT:

Sections 31 to 36 correspond to Sections 13 and 14 of the Federal Reserve Act. The reader will readily see how much of the National Reserve Association Bill has been carried over in substance, often verbatim, into Sections 13 and 14 of the Federal Reserve Act.

It will not do to say, as Glass and Willis claim, that these sections of the National Reserve Association Bill simply contain a transcript of European central bank laws or practices, and that, therefore, they were copied as matters of commonly accepted banking technique. The transactions of European central banks include principally the discount of, or loans on,

Federal Reserve Act

OPEN-MARKET PURCHASES

SEC. 14. Any Federal reserve bank may, under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount, with or without the indorsement of a member bank.

Every Federal reserve bank shall have power: . . .

(c) To purchase from member banks and to sell, with or without its indorsement, bills of exchange arising out of commercial transactions, as hereinbefore defined;

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bankers' acceptances or double-name trade bills. Such paper did not exist here. The law had to provide, therefore, for some new device enabling the central organization safely and adequately to deal with our single-name paper; and it had to set about and create the very bankers' acceptances and modern trade bills which, in turn, would constitute a safe and readily available means of exchange between the new organization and the member and non-member banks. In devising these means, the framers of the law had constantly to bear in mind that, unless they could satisfy the country that the system proposed would be safe from abuse—by "interests," large or small, East, South, or West, or from paper befriended by the politicians—the prejudice against any kind of a central

National Reserve Association Bill
(The Aldrich Bill)

banking system could not, and should not, be overcome. In other words: the doors to the Reserve System had to be opened wide enough to render the System effective, and closed tight enough to keep danger out. Sections 31–35 of the National Reserve Association Bill represent the result of years of hard struggle with this problem.

Moreover, a Reserve System that was to exercise a regulatory influence, and not to be solely an emergency organization, had to be constructed so as to be able to function, not only as an anvil, but also as a hammer.[1]

The National Reserve Association Bill and the United Reserve Bank Plan deal with this problem in a very clear way. For the anvil operations, where the initiative rests with member banks desiring to rediscount single-name notes, only short paper (with maturities not in excess of 28 days) is admitted; where longer paper of this character is offered for rediscount, the guarantee of local associations (that is the joint obligation of the members of that district) is required. If the National Reserve Association Bill had actually been enacted, this safety appliance would probably have been eliminated after a few years of actual operation. The Federal Reserve Act could leave it out, because education had meanwhile further pro-

[1] See my address, "Hammer or Anvil," p. 819, Vol. II.

Federal Reserve Act

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gressed, and it was no longer a psychological requirement, particularly not in a system under so much stricter governmental control.

Barring the injection of the "local associations" for longer paper, the "anvil" sections in both the National Reserve Association Bill and the Federal Reserve Act are practically the same. In both cases, the safeguarding of the character of the paper is left to the Central Board, endorsement by member banks is required, and the actual discount operations are carried out, not by the Central Board, but by the 15 branches or 12 Federal reserve banks respectively.

Where "hammer" transactions were involved, i.e., transactions initiated by the Reserve System to be carried on as a matter of larger national policy, be it for the strengthening of the Reserve System, or in the exercise of a regulatory influence upon the country as a whole, the National Reserve Association Bill placed the operations involved in the hands of the Central Board; this included the purchase of bankers' acceptances, U. S. Government and State securities, and foreign bills and foreign State securities (the latter where circumstances made it desirable that, in the interest of the country, reserve funds should not be too actively employed at home).

National Reserve Association Bill
(The Aldrich Bill)

The Central Board was placed also in charge of gold and bullion operations and the establishment of accounts in foreign countries.

The Federal Reserve Act empowered every Federal reserve bank individually to carry on these "hammer" transactions. Obviously, the exercise of these functions by 12 Federal reserve banks, each acting individually, would have led to the greatest confusion and would have rendered a national and effective policy impossible. In practical operation, it was inevitable, therefore, that a plan of common action should be developed. As a result, these transactions are carried on to-day by a committee of Federal reserve bank governors, who, under the auspices of the Board, attend to the open-market investments for a common account of all Federal reserve banks willing to join in these transactions.

Important negotiations and transactions with foreign central banks have generally been carried on by the New York Federal Reserve Bank, under the auspices of the Federal Reserve Board, leaving it open to the other Federal reserve banks to join.

From the aforesaid, the reader may readily judge for himself (1) how far the Federal Reserve Act took over from the Na-

Federal Reserve Act

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tional Reserve Association Bill, in form and substance, the sections constituting the heart of the System; and (2) how far in practical operation, in spite of the outward organic difference in structure, the Federal Reserve Act, in these respects, resembles the National Reserve Association Bill.

Section 14 of the Federal Reserve Act is a very unfortunate hodgepodge. It is headed "Open-Market Operations," but contains the clauses providing for the fixing of discount rates, and other matter that has nothing whatever to do with the "open market." The most peculiar feature is that it broadly provides for the purchase of "bills of exchange" without the endorsement of a member bank, or a banking endorsement. Thus we find that, in Section 13, all kinds of restrictions and limits are imposed upon Federal reserve banks in dealing with members, while, in Section 14, the Board is given the power to permit the Federal reserve banks to deal with anybody anywhere without any of these safeguards. Fortunately, the Federal Reserve Board, notwithstanding pressure to the contrary, has acted cautiously in this respect. It is the first duty of a reserve system to keep itself safe and free from commercial credit risks. In its open-market transactions in foreign or domestic bills, Federal reserve banks must restrict

National Reserve Association Bill
(The Aldrich Bill)

themselves to investments in which a credit risk is practically excluded by the acceptance or endorsement of banks or banking firms of undoubted standing. One can readily see what would happen to the Federal Reserve System if a bill drawn by an oil producer on an oil distributor, or similar paper, could enter the portfolios of Federal reserve banks without a bank endorsement.[1]

It is now generally understood that it is not necessary for Federal reserve banks to buy paper without the protection of a bank endorsement in order to secure a proper strategic position. Such a position may be secured and modified from time to time by releasing reserve money to, or withdrawing it from actual employment in, the money market, and both the National Reserve Association Bill and the Federal Reserve

[1] The United Reserve Bank Plan proposed for the transactions covered in Section 32: Acceptances "drawn by a commercial firm on, and accepted by, a bank, trust company, or banker, and endorsed by a bank, trust company, or a banker. One of these signatures should be that of a member."

For the transactions envisaged in Section 35, the United Reserve Bank Plan proposed bills of a commercial character "to be drawn on, and accepted by, a well known foreign banking house and endorsed by a member or *a banker in good standing.*"

The United Reserve Bank Plan thus gives greater latitude for open-market operations than the National Reserve Association Bill, without going to the extreme of Section 14 of the Federal Reserve Act.

Federal Reserve Act

Act provide ample opportunities for that in permitting, in addition to the rediscount operations, investments in bankers' acceptances, U. S. Government bonds, foreign exchange, and other securities.

It is true that the National Reserve Association Bill, in restricting purchases of bankers' acceptances to those endorsed by a member bank, went too far. The reason was a political one; it was feared that the minority party, or others opposed to the bill, would have raised the cry that the door had been opened to "Wall Street," if any bills except those endorsed by member banks had been admitted for purchase by the National Reserve Association.

National Reserve Association Bill
(The Aldrich Bill)

FOREIGN CORRESPONDENTS OR AGENCIES

SEC. 36. **The National Reserve Association shall have power to open and maintain banking accounts in foreign countries and to establish agencies in foreign countries for the purpose of purchasing, selling, and collecting foreign bills of exchange, and it shall have authority to buy and sell, with or without its indorsement, through such correspondents or agencies,**

checks or prime foreign

bills of exchange arising out of commercial transactions, which have not exceeding ninety days to run, and which bear the signatures of two or more responsible parties.

(Verbatim Owen Bill)

COMMENT:

Verbatim the same, except that the language used in the Federal Reserve Act is "to appoint correspondents and establish agencies," as against, in the National Reserve Association

Federal Reserve Act

FOREIGN CORRESPONDENTS OR AGENCIES

SEC. 14. . . . Every Federal reserve bank shall have power: . . .
(e) To establish accounts with other Federal reserve banks for exchange purposes and, with the consent of the Federal Reserve Board,

to open and maintain banking accounts in foreign countries,

appoint correspondents, and

establish agencies in such countries

wheresoever it may deem best

for the purpose of purchasing, selling, and collecting bills of exchange, and to buy and sell with or without its indorsement, through such correspondents or agencies, bills of exchange arising out of actual commercial transactions which have not more than ninety days to run and which bear the signature of two or more responsible parties.

Bill, "to establish agencies," and, farther on, "through such correspondents or agencies."

For further comment, see page 300.

National Reserve Association Bill
(The Aldrich Bill)

CLEARING AND COLLECTION SYSTEM

SEC. 37. **It shall be the duty of the National Reserve Association or any of its branches, upon request, to transfer any part of the deposit balance of any bank having an account with it to the credit of any other bank having an account with the National Reserve Association.**

If a deposit balance is transferred from the books of one branch to the books of another branch, it may be done,

under regulations to be prescribed by the National Reserve Association,

by mail, telegraph, or otherwise, at rates to be fixed at the time by the manager of the branch at which the transaction originates.

SEC. 21. Any local association may by a vote of three-fourths of its members and with the approval of the National Reserve Association,

assume and exercise such of the powers and functions of a clearing house as are not inconsistent with the purposes of this Act. The National Reserve Association may require any local association to perform such services in facilitating the domestic exchanges of the National Reserve Association

as the public interests may require.

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CLEARING AND COLLECTION SYSTEM

SEC. 16. . . . **The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among Federal reserve banks and their branches, and may at its discretion exercise the functions of a clearing house for such Federal reserve banks,**

or may designate a Federal reserve bank to exercise such functions,

and may also require each such bank to exercise the functions of a clearing house for its member banks.

. . . Every Federal reserve bank shall receive on deposit at par from member banks or from Federal reserve banks checks and drafts drawn upon any of its depositors, and when remitted by a Federal reserve bank, checks and drafts drawn by any depositor in any other Federal reserve bank or member bank upon funds to the credit of said depositor in said reserve bank or member bank. Nothing herein contained shall be construed as prohibiting a member bank from charging its actual expense incurred in collecting and remitting funds, or for exchange sold to its patrons. The Federal Reserve Board shall, by rule, fix the charges to be collected by the member banks from its patrons whose checks are cleared through the Federal reserve bank and the charge which may be imposed for the service of clearing or collection rendered by the Federal reserve bank.

National Reserve Association Bill
(The Aldrich Bill)

COMMENT:

The substance is very similar in spite of difference in verbiage.

Both acts provide for a system of transfers with charges, but in the Federal Reserve Act there is the provision that checks shall be "received from member banks on deposit at par." This places the Federal Reserve System in the dilemma of either giving immediate credit at par for every check so received (thus conceivably paying cash to a member bank for a check which may only be paid six days later) or of accepting the checks on a "deferred credit basis," as done at present. If the Federal reserve banks were permitted to make an interest charge at a published bank rate for the days involved in the trip of the check to its destination (without figuring for the

Federal Reserve Act

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return trip of the remittance), the member banks, if they so desired, would be given the immediate use of their money, while the Federal reserve banks would receive some income in return, to cover the high cost of operation of their collection machinery. If the approximately $600,000,000 now carried by the Federal reserve banks in uncollected checks were thus turned into an earning asset of the Federal reserve banks, the investments in government securities of Federal reserve banks would automatically be reduced by a similar amount. By fixing the bank rate applicable to such collections high enough, the Federal Reserve System could protect itself from being forced to carry a larger amount than it desired. The Federal Reserve System would thus remain in constant touch with the market and gain an additional means of control.

National Reserve Association Bill
(The Aldrich Bill)

COMMENT:

The National Reserve Association Bill does not provide for what would be sub-branches of its branches. Section 5 (*page 202*) states only that "the districts may be readjusted and new districts and new branches may from time to time be organized by the directors of the National Reserve Association wherever in their opinion the business of the country requires."

It may not be uninteresting to mention, at this point, that, while the Federal Reserve Act does not provide in specific terms for the establishment of *foreign branches*, pressure was

Federal Reserve Act

Branches of Federal Reserve Banks

Sec. 3. Each Federal reserve bank shall establish branch banks within the Federal reserve district in which it is located and may do so in the district of any Federal reserve bank which may have been suspended. Such branches shall be operated by a board of directors under rules and regulations approved by the Federal Reserve Board. Directors of branch banks shall possess the same qualifications as directors of the Federal reserve banks. Four of said directors shall be selected by the reserve bank and three by the Federal Reserve Board, and they shall hold office during the pleasure, respectively, of the parent bank and the Federal Reserve Board. The reserve bank shall designate one of the directors as manager.

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brought to bear upon the Federal Reserve Board on several occasions to permit or force Federal reserve banks to establish branches in foreign countries. Attempts were made to give the language of Section 14 under "e" (*see page 295*) a wider construction for that purpose. That paragraph reads as follows:

". . . to open and maintain banking accounts in foreign countries, appoint correspondents, and establish agencies in such countries . . . for the purpose of purchasing, selling, and collecting bills of exchange."

This language has been taken over practically literally from the National Reserve Association Bill (*see page 294*), which, in

National Reserve Association Bill
(The Aldrich Bill)

turn, took it from the United Reserve Bank Plan (*see pp. 81–82, Vol. II*). It is certain that neither the United Reserve Bank Plan nor the National Reserve Association Bill expected that these agencies should be anything but foreign firms or institutions that would be appointed to act as agents in a manner similar to that provided for in the agency agreements which have been concluded by the Federal reserve banks with quite a number of foreign central banks. It stands to reason that if it had been the original intention of the Federal Reserve Act to permit the organization of *foreign branches in foreign countries*, a law which is so careful in prescribing in detail how domestic branches are to operate, would have been clear and specific with regard to the organization, operation, and examinations, etc., of foreign branches. At one time, Mr. McAdoo fathered such a comprehensive plan for aggressive operations

Federal Reserve Act

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by foreign branches of Federal reserve banks and President Wilson publicly endorsed it. The Federal Reserve Board, however, saw itself constrained to oppose it, and to decline to carry it into effect. In recent years, the Federal Reserve Board—against the advice of the Advisory Council—permitted two Federal reserve banks to open each a branch in Havana (Cuba), one of which has since been closed. It is a highly dangerous precedent, all the more so as there is an aggressive school of thought—of which Dr. Willis is the main exponent—urging that Federal reserve banks should go into foreign countries, and engage there in pioneer work. It is unnecessary to stress the reasons why it would run counter to every sound theory of reserve banking to use reserve funds of a country for such purposes.

National Reserve Association Bill
(The Aldrich Bill)

Reserves

Sec. 39. All subscribing banks must conform to the following requirements as to reserves to be held against deposits of various classes, but the deposit balance of any subscribing bank in the National Reserve Association and any notes of the National Reserve Association which it holds may be counted as the whole or any part of its required reserve:

First. On demand deposits: National banks in different localities shall maintain the same percentages of reserve against demand deposits as is now required by law, and the same percentages of reserve against demand deposits shall be required of all other subscribing banks in the same localities.

Second. On time deposits: All time deposits and moneys held in trust payable or maturing within thirty days shall be subject to the same reserve requirements as demand deposits in the same locality. All time deposits and moneys held in trust payable or maturing more than thirty days from date shall be subject to the same reserve requirements as demand deposits for the thirty days preceding their maturity, but no reserves shall be required therefor except for this period. Such time deposits and moneys held in trust, payable only at a stated time not less than thirty days from date of deposit, must be represented by certificates or instruments in writing and must not be allowed to be withdrawn before the time specified without thirty days' notice.

Federal Reserve Act

RESERVES

SEC. 19. Demand deposits within the meaning of this Act shall comprise all deposits payable within thirty days, and time deposits shall comprise all deposits payable after thirty days, and all savings accounts and certificates of deposit which are subject to not less than thirty days' notice before payment.

When the Secretary of the Treasury shall have officially announced, in such manner as he may elect, the establishment of a Federal reserve bank in any district, every subscribing member bank shall establish and maintain reserves as follows:

(a) A bank not in a reserve or central reserve city as now or hereafter defined shall hold and maintain reserves equal to twelve per centum of the aggregate amount of its demand deposits and five per centum of its time deposits, as follows:

In its vaults for a period of thirty-six months after said date five-twelfths thereof and permanently thereafter four-twelfths.

In the Federal reserve bank of its district, for a period of twelve months after said date, two-twelfths, and for each succeeding six months an additional one-twelfth, until five-twelfths have been so deposited, which shall be the amount permanently required.

For a period of thirty-six months after said date the balance of the reserves may be held in its own vaults, or in the Federal reserve bank, or in national banks in reserve or central reserve cities as now defined by law.

National Reserve Association Bill
(The Aldrich Bill)

Federal Reserve Act

After said thirty-six months' period said reserves, other than those hereinbefore required to be held in the vaults of the member bank and in the Federal reserve bank, shall be held in the vaults of the member bank or in the Federal reserve bank, or in both, at the option of the member bank.

(b) A bank in a reserve city, as now or hereafter defined, shall hold and maintain reserves equal to fifteen per centum of the aggregate amount of its demand deposits and five per centum of its time deposits, as follows:

In its vaults for a period of thirty-six months after said date six-fifteenths thereof, and permanently thereafter five-fifteenths.

In the Federal reserve bank of its district for a period of twelve months after the date aforesaid at least three-fifteenths, and for each succeeding six months an additional one-fifteenth, until six-fifteenths have been so deposited, which shall be the amount permanently required.

For a period of thirty-six months after said date the balance of the reserves may be held in its own vaults, or in the Federal reserve bank, or in national banks in reserve or central reserve cities as now defined by law.

After said thirty-six months' period all of said reserves, except those hereinbefore required to be held permanently in the vaults of the member bank and in the Federal reserve bank, shall be held in its vaults or in the Federal reserve bank, or in both, at the option of the member bank.

(c) A bank in a central reserve city, as now or hereafter defined, shall hold and maintain a reserve equal to eighteen per centum of the aggregate amount of its demand deposits and five per centum of its time deposits, as follows:

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(The Aldrich Bill)

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In its vaults six-eighteenths thereof.

In the Federal reserve bank seven-eighteenths.

The balance of said reserves shall be held in its own vaults or in the Federal reserve bank, at its option.

Any Federal reserve bank may receive from the member banks as reserves, not exceeding one-half of each installment, eligible paper as described in section fourteen properly indorsed and acceptable to the said reserve bank.

. . . Except as thus provided, no member bank shall keep on deposit with any nonmember bank a sum in excess of ten per centum of its own paid-up capital and surplus. No member bank shall act as the medium or agent of a nonmember bank in applying for or receiving discounts from a Federal reserve bank under the provisions of this Act except by permission of the Federal Reserve Board.

The reserve carried by a member bank with a Federal reserve bank may, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities: *Provided, however*, That no bank shall at any time make new loans or shall pay any dividends unless and until the total reserve required by law is fully restored.

In estimating the reserves required by this Act, the net balance of amounts due to and from other banks shall be taken as the basis for ascertaining the deposits against which reserves shall be determined. Balances in reserve banks due to member banks shall, to the extent herein provided, be counted as reserves.

National banks located in Alaska or outside the continental United States may remain nonmember banks, and shall in that event maintain reserves and comply with all the conditions now provided by law regulating them; or said banks, except in the Philippine Islands, may, with the consent of the Reserve Board,

National Reserve Association Bill
(The Aldrich Bill)

COMMENT:

When comparing the National Reserve Association Bill and the Federal Reserve Act, it is necessary to deal with the sections containing the reserve provisions and those governing the note issue at the same time. These sections and the rediscount and investment clauses cover the most important features of the two bills.

The characteristic idea of the United Reserve Bank Plan was that it devised a scheme by which a substantial portion of the idle gold reserves tied up in the vaults of thousands of banks was to be transferred to a central reservoir and the credit balances at the central reservoir thus created were to be counted as part of the lawful reserves of these banks.

The scheme went further, however, in that it stipulated that the cash which remained tied up in the member bank vaults in percentages required by the old law, might consist of the circulating notes of the United Reserve Bank. Thus it was hoped that practically all the gold tied up in the banks would flow into the central reservoir, while the balance with the United Reserve Bank and its notes in the hands of the member banks would constitute the reserves of the latter.

It was furthermore hoped to substitute the United Reserve Bank notes for the gold circulation in the pockets and tills of the people, thus making the United Reserve Bank a huge gold reservoir, an organization of unparalleled strength.

If the old requirements of 25 per cent, 25 per cent, and 15 per cent, respectively, to be maintained against demand deposits, were to be left unchanged, then the balances with

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become member banks of any one of the reserve districts, and shall, in that event, take stock, maintain reserves, and be subject to all the other provisions of this Act.

SEC. 20. So much of sections two and three of the Act of June twentieth, eighteen hundred and seventy-four, entitled "An Act fixing the amount of United States notes, providing for a redistribution of the national-bank currency, and for other purposes," as provides that the fund deposited by any national banking association with the Treasurer of the United States for the redemption of its notes shall be counted as a part of its lawful reserve as provided in the Act aforesaid, is hereby repealed. And from and after the passage of this Act such fund of five per centum shall in no case be counted by any national banking association as a part of its lawful reserve.

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so-called reserve and central reserve agents were to be continued to the extent that they were not kept as balance or in vault.

If, in due course, these balances with reserve and central reserve agents were to be abolished as part of the required reserve—which was the sounder course—then logically the total of reserves required was to be correspondingly reduced. If the balance with the United Reserve Bank was to be considered the only reserve, and the till money of the member banks was not to be counted as reserve, then a further reduction would be called for.

National Reserve Association Bill
(The Aldrich Bill)

The National Reserve Association Bill adopted the principle of this plan. It is true that in its first draft it stopped half way by not permitting the National Reserve Association notes in the vaults of members to be counted as reserves.

This was modified, however, in the second and final edition of the plan, and the National Reserve Association Bill provided, therefore, for complete gold concentration.

The National Reserve Association Bill did not provide, however, for a definite percentage to be maintained as a balance with the central organization, and it left it to the discretion of the Executive Committee to determine the size of these balances in each individual case. In this, it followed the European plan where the central banks require their depositors to maintain balances commensurate with their scope and standing, and with the business done with the central institution. There do not exist any legal reserve requirements in Europe. (It is to be assumed that, in actual operation, the National Reserve Association would promptly have evolved a definite rule, based on deposits of member banks, because with thousands of members individual arbitrary arrangements would at once have led to an impasse and trouble.)

The National Reserve Association Bill left unchanged the old provisions of the law permitting balances maintained with other banks, as reserve agents, or central reserve agents, to be counted as part of the required reserve.[1]

[1] In the United Reserve Bank Plan (March, 1910), I decided to remain rather vague with regard to reserve requirements, for fear that if I were specific the discussion would at once center on this detail. Antagonism would be

Federal Reserve Act

The Federal Reserve Act, on the other hand, clearly prohibited balances with other banks after a period of transition to be counted as part of the required reserves and prescribed definite percentages of demand and time deposits to be maintained either as a balance with the Federal reserve banks, or as vault cash, while a certain amount was to be carried optionally either in vault or as a balance. It did not, however, permit Federal reserve notes in the vaults of member banks to be counted as reserve money.

The first drafts of the Federal Reserve Act provided for the placing with the Federal reserve bank or in the member banks' own vaults of the entire "reserve required" under the old law. A large portion of these reserves not having been held in actual cash, but having been actively employed by the reserve and central reserve agents, this very drastic stipulation was likely to cause substantial contraction and to alarm and antagonize the banks. On second thought, the bill was modified and requirements were reduced from 15 per cent, 25 per cent, and 25 per cent to 12 per cent, 15 per cent, and 18 per cent respectively. (This was in keeping with my rec-

aroused too early and a quiet discussion of the larger points involved would become jeopardized. I confined myself to the following statement: "The general banks will hold a sufficient amount of till money for their requirements, but as a reserve they must hold a cash balance with the United Reserve Bank, commensurate as at present with the aggregate amount of their deposits." It is fair to assume that Senator Aldrich avoided for the same reason being more specific in submitting his bill. Senator Glass vividly describes the bitter resistance that these clauses called forth on the part of the banks when the Federal Reserve Act boldly provided for specific reserve balances. It was a matter of prudence to avoid that issue in the early stages of the discussion.

National Reserve Association Bill
(The Aldrich Bill)

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ommendation contained in the memorandum addressed to Colonel House under date of April 22, 1913.)

Thus the Federal Reserve Act was superior to the National Reserve Association Bill in venturing to deal more definitely with the question of the character and size of reserves; it was inferior in that it continued the obligatory requirement of keeping a certain percentage in vault in lawful money and in that it precluded Federal reserve notes from being counted as reserve money, thereby preventing the free flow of gold into the Federal reserve banks and placing a strong obstruction in the path of their growth. As long as Federal reserve notes were made a second-class currency, obviously the member banks were likely to lock up in their vaults, in gold or legal tender, not only the required portion of their reserves, but also the optional portion.

In theory and practice, the provisions of the Federal Reserve Act thus were greatly inferior to those of the National Reserve Association Bill.

It is impossible to repeat here all the arguments made in this respect in earlier articles; suffice it to say that the great strength enjoyed by the Federal Reserve System to-day could not have been attained had not the original reserve sections and the clauses regulating the note issue—with which we shall deal presently—been thoroughly recast. The Federal Reserve System would have remained dwarfed. Its gold holdings

Federal Reserve Act

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would have remained restricted to the obligatory balances of the members, plus what little of the "optional" they might have secured. They could not have drawn gold from circulation. On the other hand, being obliged to put up 100 per cent collateral in bills discounted for all Federal reserve notes they might issue, while they were to maintain *in addition* not less than 40 per cent in gold, a total of 140 per cent, they would have reached the end of their tether so much quicker.

After a thorough overhauling, the reserve provisions of the Federal Reserve Act are very simple to-day. They provide that member banks, against their demand liabilities, shall maintain balances with their respective Federal reserve banks as follows: country banks 7 per cent, reserve city banks 10 per cent, and central reserve city banks 13 per cent; they may hold in their vaults whatever kind of money they like, and as much or as little as they require; but their vault money is no longer to be counted as reserve, nor are their balances with banks other than the Federal reserve bank.

This is what the United Reserve Bank Plan proposed in 1910, and follows closely the principles of the National Reserve Association Bill, with the exception that, as already stated, the earlier plans left undefined the specific percentages of the reserve requirements.

National Reserve Association Bill
(The Aldrich Bill)

LOANS ON REAL ESTATE

SEC. 40. National banks may loan not more than

thirty per centum of their time deposits,

as herein defined,

upon improved and unencumbered real estate,

such loans

not to exceed fifty per centum of the actual value of the property,

which property shall be situated in the vicinity or in the territory directly tributary to the bank: *Provided*, That this privilege shall not be extended to banks acting as reserve agents for banks or trust companies.

COMMENT:

M.M.S.—except that the Federal Reserve Act restricts these loans to *farm* lands, while the National Reserve Association Bill restricts them to "improved real estate."

Federal Reserve Act

LOANS ON FARM LANDS

SEC. 24. Any national banking association not situated in a central reserve city may make loans secured by

improved and unencumbered

farm

land,

situated within its Federal reserve district, but no such loan shall be made for a longer time than five years, nor for an amount

exceeding fifty per centum of the actual value of the property

offered as security. Any such bank may make such loans in an aggregate sum equal to twenty-five per centum of its capital and surplus or

to one-third of its time deposits

and such banks may continue hereafter as heretofore to receive time deposits and to pay interest on the same.

The Federal Reserve Board shall have power from time to time to add to the list of cities in which national banks shall not be permitted to make loans secured upon real estate in the manner described in this section.

National Reserve Association Bill
(The Aldrich Bill)

Reserves Against Deposits and Notes

Sec. 41. All demand liabilities, including deposits and circulating notes, of the National Reserve Association shall be covered to the extent of fifty per centum by a reserve of gold (including foreign gold coin and gold bullion) or other money of the United States which the national banks are now authorized to hold as a part of their legal reserve: *Provided*, That whenever and so long as such reserve shall fall and remain below fifty per centum the National Reserve Association shall pay a special tax upon the deficiency of reserve at a rate increasing in proportion to such deficiency as follows: For each two and one-half per centum or fraction thereof that the reserve falls below fifty per centum a tax shall be levied at the rate of one and one-half per centum per annum: *Provided further*, That no additional circulating notes shall be issued whenever and so long as the amount of such reserve falls below thirty-three and one-third per centum of its outstanding notes.

Sec. 42. In computing the demand liabilities of the National Reserve Association a sum equal to one-half of the amount of the United States bonds held by the association which have been purchased from national banks, and which had previously been deposited by such banks to secure their circulating notes, shall be deducted from the amount of such liabilities.

Comment:

As minimum reserves, the National Reserve Association Bill prescribes 50 per cent against notes and demand liabilities; the Federal Reserve Act prescribes 40 per cent against notes and 35 per cent against deposits.

Federal Reserve Act

RESERVES AGAINST DEPOSITS AND NOTES

SEC. 16. . . . Every Federal reserve bank shall maintain reserves in gold or lawful money of not less than thirty-five per centum against its deposits and reserves in gold of not less than forty per centum against its Federal reserve notes in actual circulation, and not offset by gold or lawful money deposited with the Federal reserve agent. . . .

SEC. 11. The Federal Reserve Board shall be authorized and empowered:

. . . (c) To suspend for a period not exceeding thirty days, and from time to time to renew such suspension for periods not exceeding fifteen days, any reserve requirement specified in this Act: *Provided*, That it shall establish a graduated tax upon the amounts by which the reserve requirements of this Act may be permitted to fall below the level hereinafter specified: *And Provided*, further, that when the gold reserve held against Federal reserve notes falls below forty per centum, the Federal Reserve Board shall establish a graduated tax of not more than one per centum per annum upon such deficiency until the reserves fall to thirty-two and one-half per centum, and when said reserve falls below thirty-two and one-half per centum, a tax at the rate increasingly of not less than one and one-half per centum per annum upon each two and one-half per centum or fraction thereof that such reserve falls below thirty-two and one-half per centum. The tax shall be paid by the reserve bank, but the reserve bank shall add an amount equal to said tax to the rates of interest and discount fixed by the Federal Reserve Board.

As taxes on deficient reserves, the National Reserve Association Bill specifies 1½ per cent per annum, increasing in proportion, for each 2½ per cent deficiency below 50 per cent, and if the reserve falls below 33⅓ per cent, no additional circulation is to be issued; the Federal Reserve Act specifies

National Reserve Association Bill
(The Aldrich Bill)

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a graduated tax of 1 per cent per annum for deficiency if the reserve against notes falls below 40 per cent to 32½ per cent and a graduated tax of 1½ per cent for each 2½ per cent deficiency below 32½ per cent.

Federal Reserve Act

The last part of Paragraph C of Section 11 of the Federal Reserve Act, reading as follows: "The tax shall be paid by the reserve bank, but the reserve bank shall add an amount equal to said tax to the rates of interest and discount fixed by the Federal Reserve Board" has always been considered by me as one of the most fascinating prize puzzles.

National Reserve Association Bill
(The Aldrich Bill)

Weekly Report of Condition

Sec. 43. The National Reserve Association shall make a report, showing the principal items of its balance sheet, to the Comptroller of the Currency

once a week. These reports shall be made public.

In addition, full reports shall be made to the Comptroller of the Currency by said association coincident with the five reports called for each year from the national banks.

Comment:

M.M.S.

Federal Reserve Act

WEEKLY REPORT OF CONDITION

SEC. 11. . . . The said board

shall publish once each week

a statement showing the condition of each Federal reserve bank and a consolidated statement for all Federal reserve banks. Such statements shall show in detail the assets and liabilities of the Federal reserve banks, single and combined, and shall furnish full information regarding the character of the money held as reserve and the amount, nature and maturities of the paper and other investments owned or held by Federal reserve banks.

National Reserve Association Bill
(The Aldrich Bill)

REPORTS AND EXAMINATIONS

SEC. 44. All subscribing banks shall, under regulations to be prescribed by the National Reserve Association, make a report monthly, or oftener if required, to said association showing the principal items of their balance sheets.

SEC. 45. All reports of national-bank examiners in regard to the condition of banks shall hereafter be made in duplicate, and one copy shall be filed with the National Reserve Association for the confidential use of its executive officers and branch managers.

SEC. 46. The National Reserve Association

may accept

copies of the reports of the national-bank examiners for subscribing national banks and also

copies of the reports of State-bank examiners for subscribing State banks and trust companies,

in States where the furnishing of such information is not contrary to law: *Provided, however*, That the standard of such examinations, both National and State, meets the requirements prescribed by the National Reserve Association. The National Reserve Association

shall have the right at any time to examine or cause to be examined by its own representatives any subscribing bank.

The National Reserve Association may make such payments to national and State examiners for such services required of them as the directors may consider just and equitable.

Federal Reserve Act

REPORTS AND EXAMINATIONS

SEC. 21. Section fifty-two hundred and forty, United States Revised Statutes, is amended to read as follows:

The Comptroller of the Currency, with the approval of the Secretary of the Treasury, shall appoint examiners who shall examine every member bank at least twice in each calendar year and oftener if considered necessary: *Provided, however,*

That the Federal Reserve Board may authorize examination by the State authorities to be accepted in the case of State banks and trust companies

and may at any time direct the holding of

a special examination of State banks or trust companies

that are stockholders in any Federal reserve bank. The examiner making the examination of any national bank, or of any other member bank, shall have power to make a thorough examination of all the affairs of the bank and in doing so he shall have power to administer oaths and to examine any of the officers and agents thereof under oath and shall make a full and detailed report of the condition of said bank to the Comptroller of the Currency.

The Federal Reserve Board, upon the recommendation of the Comptroller of the Currency, shall fix the salaries of all bank examiners and make report thereof to Congress. The expense of the examinations herein provided for shall be assessed by the Comptroller of the Currency upon the banks examined in proportion to assets or resources held by the banks upon the dates of examination of the various banks.

National Reserve Association Bill
(The Aldrich Bill)

COMMENT:

M.M.S.

Federal Reserve Act

In addition to the examinations made and conducted by the Comptroller of the Currency, every

Federal reserve bank may,

with the approval of the Federal reserve agent or the Federal Reserve Board,

provide for special examination of member banks

within its district. The expense of such examinations shall be borne by the bank examined. Such examinations shall be so conducted as to inform the Federal reserve bank of the condition of its member banks and of the lines of credit which are being extended by them. Every Federal reserve bank shall at all times furnish to the Federal Reserve Board such information as may be demanded concerning the condition of any member bank within the district of the said Federal reserve bank.

No bank shall be subject to any visitatorial powers other than such as are authorized by law, or vested in the courts of justice or such as shall be or shall have been exercised or directed by Congress, or by either House thereof or by any committee of Congress or of either House duly authorized.

National Reserve Association Bill
(The Aldrich Bill)

PARTIAL REPEAL OF SECTION 5159

SEC. 47. **All provisions of law requiring national banks to hold or to transfer and deliver to the Treasurer of the United States bonds of the United States other than those required to secure outstanding circulating notes and Government deposits are hereby repealed.**

COMMENT:

M.M.S.

Federal Reserve Act

PARTIAL REPEAL OF SECTION 5159

SEC. 17. **So much of the provisions**

of section fifty-one hundred and fifty-nine of the Revised Statutes of the United States, and section four of the Act of June twentieth, eighteen hundred and seventy-four, and section eight of the Act of July twelfth, eighteen hundred and eighty-two, and of any other provisions of existing statutes

as require that before any national banking associations shall be authorized to commence banking business it shall transfer and deliver to the Treasurer of the United States a stated amount of United States registered bonds is hereby repealed.

National Reserve Association Bill
(The Aldrich Bill)

Retirement of National Bank Currency and Conversion of Two per cent Bonds

Sec. 48. There shall be no further issue of circulating notes by any national bank beyond the amount now outstanding. National banks may maintain their present note issue, but

Federal Reserve Act

Retirement of National Bank Currency and Conversion of Two per cent Bonds

Sec. 18. After two years from the passage of this Act, and at any time during a period of twenty years thereafter, any member bank desiring to retire the whole or any part of its circulating notes, may file with the Treasurer of the United States an application to sell for its account, at par and accrued interest, United States bonds securing circulation to be retired.

The Treasurer shall, at the end of each quarterly period, furnish the Federal Reserve Board with a list of such applications, and the Federal Reserve Board may, in its discretion, require the Federal reserve banks to purchase such bonds from the banks whose applications have been filed with the Treasurer at least ten days before the end of any quarterly period at which the Federal Reserve Board may direct the purchase to be made: *Provided*, That Federal reserve banks shall not be permitted to purchase an amount to exceed $25,000,000 of such bonds in any one year, and which amount shall include bonds acquired under section four of this Act by the Federal reserve bank.

Provided further, That the Federal Reserve Board shall allot to each Federal reserve bank such proportion of such bonds as the capital and surplus of such bank shall bear to the aggregate capital and surplus of all the Federal reserve banks.

Upon notice from the Treasurer of the amount of bonds so sold for its account, each member bank shall duly assign and transfer, in writing, such bonds to the Federal reserve bank pur-

National Reserve Association Bill
(The Aldrich Bill)

whenever a bank retires the whole or any part of its existing issue its right to reissue the notes so retired shall thereupon cease.

SEC. 49. The National Reserve Association shall, for a period of one year from the date of its organization, offer to purchase at a price not less than par and accrued interest the two per centum bonds held by subscribing national banks and deposited to secure their circulating notes. The National Reserve Association shall take over the bonds so purchased and assume responsibility for the redemption upon presentation of outstanding notes secured thereby.

The National Reserve Association shall issue, on the terms herein provided, its own notes as the outstanding notes secured by such bonds

so held shall be presented for redemption and may issue further notes from time to time to meet business requirements, it being the policy of the United States to retire as rapidly as possible, consistent with the public interests, bond-secured circulation and to substitute therefor notes of the National Reserve Association of a character and secured and redeemed in the manner provided for in this Act.

Federal Reserve Act

chasing the same, and such Federal reserve bank shall, thereupon, deposit lawful money with the Treasurer of the United States for the purchase price of such bonds, and the Treasurer shall pay to the member bank selling such bonds any balance due after deducting a sufficient sum to redeem its outstanding notes secured by such bonds,

which notes shall be canceled and permanently retired when redeemed.

The Federal reserve banks

purchasing such bonds shall be permitted to take out an amount of circulating notes equal to the par value of such bonds.

Upon the deposit with the Treasurer of the United States of bonds so purchased, or any bonds with the circulating privilege acquired under section four of this Act, any Federal reserve bank

National Reserve Association Bill
(The Aldrich Bill)

SEC. 55. Upon application of the National Reserve Association the Secretary of the Treasury shall exchange the two per centum bonds of the United States bearing the circulation privilege purchased from subscribing banks for three per centum bonds of the United States without the circulation privilege, payable after fifty years from the date of issue. The National Reserve Association shall hold the three per centum bonds so issued during the period of its corporate existence: *Provided*, That after five years from the date of its organization the Secretary of the Treasury may at his option permit the National Reserve Association to sell not more than fifty million dollars of such bonds annually: *And provided further*, That the United States reserves the right at any time to pay any of such bonds before maturity, or to purchase any of them at par for the trustees of the postal savings, or otherwise.

SEC. 56. The National Reserve Association shall pay to the Government a special franchise tax of one and one-half per centum annually during the period of its charter upon an amount equal to the par value of such United States bonds transferred to it by the subscribing banks.

COMMENT:

The idea of a gradual withdrawal of national bank currency and of a gradual conversion of the 2 per cent U. S. bonds bearing the circulation privilege into 3 per cent U. S. Government securities without the circulation privilege is taken over

Federal Reserve Act

making such deposit in the manner provided by existing law, shall be entitled to receive from the Comptroller of the Currency circulating notes in blank, registered and countersigned as provided by law, equal in amount to the par value of the bonds so deposited. Such notes shall be the obligations of the Federal reserve bank procuring the same, and shall be in form prescribed by the Secretary of the Treasury, and to the same tenor and effect as national-bank notes now provided by law. They shall be issued and redeemed under the same terms and conditions as national-bank notes except that they shall not be limited to the amount of the capital stock of the Federal reserve bank issuing them.

Upon application of any Federal reserve bank, approved by the Federal Reserve Board, the Secretary of the Treasury may issue, in exchange for United States two per centum gold bonds bearing the circulation privilege, but against which no circulation is outstanding, one-year gold notes of the United States without the circulation privilege, to an amount not to exceed one-half of the two per centum bonds so tendered for exchange, and thirty-year three per centum gold bonds without the circulation privilege for the remainder of the two per centum bonds so tendered: *Provided*, That at the time of such exchange the Federal reserve bank obtaining such one-year gold notes shall enter into an obligation with the Secretary of the Treasury binding itself to purchase from the United States for gold at the maturity of such one-year notes, an amount equal to those delivered in exchange for such bonds, if so requested by the Secretary, and at each maturity of one-year notes so purchased by such Federal reserve bank, to purchase

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by the Federal Reserve Act from the National Reserve Association Bill with the following differences:

The National Reserve Association, for one year, is to offer to take over at not less than par the 2 per cent bonds held

National Reserve Association Bill
(The Aldrich Bill)

by subscribing banks and is to assume the circulation outstanding thereagainst.

The National Reserve Association may convert the 2 per cent bonds into 3 per cent fifty-year bonds (without circulation privilege).

After five years, with the approval of the Secretary of the Treasury, it may sell not more than $50,000,000 a year.

The National Reserve Association is to pay a franchise tax of 1½ per cent per annum upon the par value of bonds transferred to it by member banks.

The Federal Reserve Act provides that after two years from the passage of the Act, Federal reserve banks shall buy, not in excess of $25,000,000, 2 per cent bonds at par if tendered by national banks.

Federal reserve banks may issue their own notes against bonds so bought.

Federal reserve banks are to have the privilege of exchanging 2 per cent bonds, one-half into thirty-year 3 per cent bonds and one-half into one-year notes of the United States, which the Federal reserve banks obligate themselves to renew for a period of thirty years.

The underlying ideas of this Federal Reserve Act conversion plan are contained in the United Reserve Bank Plan. They differ in some detail.

It is not worth while analyzing these sections any further,

Federal Reserve Act

from the United States such an amount of one-year notes as the Secretary may tender to such bank, not to exceed the amount issued to such bank in the first instance, in exchange for the two per centum United States gold bonds; said obligation to purchase at maturity such notes shall continue in force for a period not to exceed thirty years.

For the purpose of making the exchange herein provided for, the Secretary of the Treasury is authorized to issue at par Treasury notes in coupon or registered form as he may prescribe in denominations of one hundred dollars, or any multiple thereof, bearing interest at the rate of three per centum per annum, payable quarterly, such Treasury notes to be payable not more than one year from the date of their issue in gold coin of the present standard value, and to be exempt as to principal and interest from the payment of all taxes and duties of the United States except as provided by this Act, as well as from taxes in any form by or under State, municipal, or local authorities. And for the same purpose, the Secretary is authorized and empowered to issue United States gold bonds at par, bearing three per centum interest payable thirty years from date of issue, such bonds to be of the same general tenor and effect and to be issued under the same general terms and conditions as the United States three per centum bonds without the circulation privilege now issued and outstanding.

Upon application of any Federal reserve bank, approved by the Federal Reserve Board, the Secretary may issue at par such three per centum bonds in exchange for the one-year gold notes herein provided for.

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inasmuch as, in consequence of the War and the issue of the war loans, conditions have changed so radically that the conversion ideas as then proposed have become impracticable. Meanwhile, the still outstanding 2 per cent bonds are beginning to near maturity, and the problem will then have to be faced and solved for good and all.

National Reserve Association Bill
(The Aldrich Bill)

NOTE ISSUE

SEC. 52. The circulating notes of the National Reserve Association

shall constitute a first lien upon all its assets and shall be redeemable in lawful money on presentation at the head office of said association or any of its branches.

It shall be the duty of the National Reserve Association to maintain at all times a parity of value of its circulating notes with the standard established by the first section of the act of

March fourteenth, nineteen hundred, entitled "An act to define and fix the standard of value, to maintain the parity of all forms of money issued or coined by the United States, to refund the public debt, and for other purposes."

COMMENT:

M. M. S.

Federal Reserve Act

NOTE ISSUE

SEC. 26. All provisions of law inconsistent with or superseded by any of the provisions of this Act are to that extent and to that extent only hereby repealed: *Provided*,

> **nothing in this Act contained shall be construed to repeal the parity provision or provisions contained in an Act approved March fourteenth, nineteen hundred entitled "An act to define and fix the standard of value, to maintain the parity of all forms of money issued or coined by the United States, to refund the public debt, and for other purposes,"**

and the Secretary of the Treasury may for the purpose of maintaining such parity and to strengthen the gold reserve, borrow gold on the security of United States bonds authorized by section two of the Act last referred to or for one-year gold notes bearing interest at a rate of not to exceed three per centum per annum, or sell the same if necessary to obtain gold. When the funds of the Treasury on hand justify, he may purchase and retire such outstanding bonds and notes.

SEC. 16. . . . and the amount of

> **such Federal reserve notes so issued to**

any such bank shall, upon delivery, together with such notes of such Federal reserve bank as may be issued under Section Eighteen of this Act upon security of United States two per centum Government bonds,

> **become a first and paramount lien on all the assets of such bank.**

National Reserve Association Bill
(The Aldrich Bill)

SEC. 53. The circulating notes of the National Reserve Association shall

be received at par in payment of all taxes, excises, and other dues

to the United States, and for all salaries and other debts and demands owing by the United States to individuals, firms, corporations, or associations, except obligations of the Government which are by their terms specifically payable in gold, and for all debts due

from or by one bank or trust company to another, and for all obligations due to any bank or trust company.

Federal Reserve Act

SEC. 16. Federal reserve notes, to be issued at the discretion of the Federal Reserve Board for the purpose of making advances to Federal reserve banks through the Federal reserve agents as hereinafter set forth and for no other purpose, are hereby authorized.

The said notes

shall be obligations of the United States and

shall be receivable by all national and member banks

and Federal reserve banks and

for all taxes,

customs,

and other public dues.

They shall be redeemed in gold on demand at the Treasury Department of the United States, in the city of Washington, District of Columbia, or in gold or lawful money at any Federal reserve bank.

Any Federal reserve bank may make application to the local Federal reserve agent for such amount of the Federal reserve notes hereinbefore provided for as it may require. Such application shall be accompanied with a tender to the local Federal reserve

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(The Aldrich Bill)

SEC. 50. All note issues of the National Reserve Association shall at all times be covered

by legal reserves to the extent required by section forty-one of this Act and by notes or bills of exchange arising out of commercial transactions as hereinbefore defined or obligations of the United States.

SEC. 51. Any notes of the National Reserve Association in circulation at any time in excess of nine hundred million dollars which are not covered by an equal amount of lawful money, gold bullion, or foreign gold coin held by said association, shall pay a special tax at the rate of one and one-half per centum per annum, and any notes in excess of one billion two hundred million dollars not so covered shall pay a special tax at the rate of five per centum per annum: *Provided*, That in computing said amounts of nine

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agent of collateral in amount equal to the sum of the Federal reserve notes thus applied for and issued pursuant to such application. The collateral security thus offered shall be

notes and bills,

accepted for rediscount under the provisions of section thirteen of this Act, and the Federal reserve agent shall each day notify the Federal Reserve Board of all issues and withdrawals of Federal reserve notes to and by the Federal reserve bank to which he is accredited. The said Federal Reserve Board may at any time call upon a Federal reserve bank for additional security to protect the Federal reserve notes issued to it.

Every Federal reserve bank shall maintain reserves in gold or lawful money of not less than thirty-five per centum against its deposits and reserves in gold of not less than forty per centum against its Federal reserve notes in actual circulation,

and not offset by gold or lawful money deposited with the Federal reserve agent. Notes so paid out shall bear upon their faces a distinctive letter and serial number, which shall be assigned by the Federal Reserve Board to each Federal reserve bank. Whenever Federal reserve notes issued through one Federal reserve bank shall be received by another Federal reserve bank they shall be promptly returned for credit or redemption to the Federal reserve bank through which they were originally issued. No Federal re-

hundred million dollars and one billion two hundred million dollars the aggregate amount of any national-bank notes then outstanding shall be included.

Federal Reserve Act

serve bank shall pay out notes issued through another under penalty of a tax of ten per centum upon the face value of notes so paid out. Notes presented for redemption at the Treasury of the United States shall be paid out of the redemption fund and returned to the Federal reserve banks through which they were originally issued, and thereupon such Federal reserve bank shall, upon demand of the Secretary of the Treasury, reimburse such redemption fund in lawful money or, if such Federal reserve notes have been redeemed by the Treasurer in gold or gold certificates, then such funds shall be reimbursed to the extent deemed necessary by the Secretary of the Treasury in gold or gold certificates, and such Federal reserve bank shall, so long as any of its Federal reserve notes remain outstanding, maintain with the Treasurer in gold an amount sufficient in the judgment of the Secretary to provide for all redemptions to be made by the Treasurer. Federal reserve notes received by the Treasury, otherwise than for redemption, may be exchanged for gold out of the redemption fund hereinafter provided and returned to the reserve bank through which they were originally issued, or they may be returned to such bank for the credit of the United States. Federal reserve notes unfit for circulation shall be returned by the Federal reserve agents to the Comptroller of the Currency for cancellation and destruction.

The Federal Reserve Board shall require each Federal reserve bank to maintain on deposit in the Treasury of the United States a sum in gold sufficient in the judgment of the Secretary of the Treasury for the redemption of the Federal reserve notes issued

National Reserve Association Bill
(*The Aldrich Bill*)

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to such bank, but in no event less than five per centum; but such deposit of gold shall be counted and included as part of the forty per centum reserve hereinbefore required. The board shall have the right, acting through the Federal reserve agent, to grant in whole or in part or to reject entirely the application of any Federal reserve bank for Federal reserve notes; but to the extent that such application may be granted the Federal Reserve Board shall, through its local Federal reserve agent, supply Federal notes to the bank so applying, and such bank shall be charged with the amount of such notes and shall pay such rate of interest on said amount as may be established by the Federal Reserve Board, and the amount of such Federal reserve notes so issued to any such bank shall, upon delivery, together with such notes of such Federal reserve bank as may be issued under section eighteen of this Act upon security of United States two per centum Government bonds, become a first and paramount lien on all the assets of such bank.

Any Federal reserve bank may at any time reduce its liability for outstanding Federal reserve notes by depositing, with the Federal reserve agent, its Federal reserve notes, gold, gold certificates, or lawful money of the United States. Federal reserve notes so deposited shall not be reissued, except upon compliance with the conditions of an original issue.

The Federal reserve agent shall hold such gold, gold certificates, or lawful money available exclusively for exchange for the outstanding Federal reserve notes when offered by the reserve bank of which he is a director. Upon the request of the Secretary of the Treasury the Federal Reserve Board shall require the Federal

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COMMENT:

The note-issue sections of the two acts are, of course, radically different.

National Reserve Association notes are obligations of the National Reserve Association.

Federal reserve notes are obligations of the United States of America.

National Reserve Association notes are issued against notes, bills of exchange, and gold.

Federal reserve notes are issued against 100 per cent notes and bills accepted for *rediscount*[1] deposited with the Federal reserve agent; *in addition*, there must be a reserve of not less than 40 per cent in gold.

Federal reserve banks shall pay such rate of interest on notes as may be established by the Federal Reserve Board. The Federal Reserve Board has never made any charge; if it had, every exchange of Federal reserve notes for gold would have involved a loss and the concentration of the country's gold reserve could never have been accomplished.

The Federal Reserve Board may refuse to furnish notes.

The National Reserve Association Bill imposes a tax of 1½ per cent plus 5 per cent respectively when the note issue

[1] Note that *acceptances* purchased under open-market powers could *not* be deposited as collateral against notes! (This was changed by later amendment.)

Federal Reserve Act

reserve agent to transmit so much of said gold to the Treasury of the United States as may be required for the exclusive purpose of the redemption of such notes.

Any Federal reserve bank may at its discretion withdraw collateral deposited with the local Federal reserve agent for the protection of its Federal reserve notes deposited with it and shall at the same time substitute therefor other like collateral of equal amount with the approval of the Federal reserve agent under regulations to be prescribed by the Federal Reserve Board. . . .

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exceeds $900,000,000—or $1,200,000,000—respectively of notes "not covered by an equal amount of lawful money, gold, gold bullion, or foreign gold."

The free exchange of Federal reserve notes for gold was not originally envisaged by the Federal Reserve Act. We have dealt with some of the phases connected with these features when discussing reserves (*page 313 ff.*).

In spite of these striking differences of theory and structure, the Federal Reserve System's note issue in practical operation—and with the later amendments enabling the free exchange for gold—functions in just the same manner as the National Reserve Association would have functioned. The shell, as President Wilson said, is a government obligation; the substance is a bank note. The red tape necessary in order to satisfy these two requirements, while costly and bothersome, is in itself not an unbearable hardship. The gravest consequence of the surrender to the Owen-Bryan theory was that, by permitting Federal reserve notes to become the obligations of the United States, the fateful demand for a Federal Reserve Board entirely appointed by the government became irresistible.

National Reserve Association Bill
(The Aldrich Bill)

No Charge for Transportation of National Reserve Association Circulation

Sec. 54. The National Reserve Association and its branches shall at once, upon application and without charge for transportation, forward its circulating notes to any depositing bank against its credit balance.

Federal Reserve Act

COMMENT:

The Federal Reserve Act contains no such provision, but since October, 1918, all Federal reserve banks, by order of the Board, have been absorbing the cost of note shipments to and from member banks.

National Reserve Association Bill
(The Aldrich Bill)

FOREIGN CORPORATIONS

SEC. 57. That banking corporations for carrying on the business of banking in foreign countries and in aid of the commerce of the United States with foreign countries and to act when required as fiscal agents of the United States in such countries may be formed by any number of persons, not less in any case than five, who shall enter into articles of association which shall specify in general terms the object for which the banking corporation is formed and may contain any other provisions not inconsistent with the provisions of this section which the banking corporation may see fit to adopt for the regulation and conduct of its business and affairs, which said regulations shall be signed, in duplicate, by the persons uniting to form the banking corporation and one copy thereof shall be forwarded to the Comptroller of the Currency and the other to the Secretary of State, to be filed and preserved in their offices.

That the persons uniting to form such banking corporation shall under their hands make an organization certificate which shall specify, first, the name assumed by such banking corporation, which name shall be subject to approval by the comptroller; second, the foreign country or countries or the dependencies or colonies of foreign countries or the dependencies of the United States where its banking operations are to be carried on; third, the place in the United States where its home office shall be located; fourth, the amount of its capital stock and the number

Federal Reserve Act

Foreign Corporations and Foreign Branches

Sec. 25. Any national banking association possessing a capital and surplus of $1,000,000 or more may file application with the Federal Reserve Board, upon such conditions and under such regulations as may be prescribed by the said board, for the purpose of securing authority to establish branches in foreign countries or dependencies of the United States for the furtherance of the foreign commerce of the United States, and to act, if required to do so, as fiscal agents of the United States. Such application shall specify, in addition to the name and capital of the banking association filing it, the place or places where the banking operations proposed are to be carried on, and the amount of capital set aside for the conduct of its foreign business. The Federal Reserve Board shall have power to approve or to reject such application if, in its judgment, the amount of capital proposed to be set aside for the conduct of foreign business is inadequate, or if for other reasons the granting of such application is deemed inexpedient.

Every national banking association which shall receive authority to establish foreign branches shall be required at all times to furnish information concerning the condition of such branches to the Comptroller of the Currency upon demand, and the Federal Reserve Board may order special examinations of the said foreign branches at such time or times as it may deem best. Every such national banking association shall conduct the accounts of each foreign branch independently of the accounts of other foreign branches established by it and of its home office, and shall at the end of each fiscal period transfer to its general ledger the profit or loss accruing at each branch as a separate item.

of shares into which the same shall be divided; fifth, the names and places of residence of the shareholders and the number of shares held by each of them; and, sixth, a declaration that said certificate is made to enable such persons to avail themselves of the advantages of this section.

That no banking corporation shall be organized under the provisions of this section with a less capital than two million dollars, which shall be fully paid in before the banking corporation shall be authorized to commence business, and the fact of said payment shall be certified by the Comptroller of the Currency and a copy of his certificate to this effect shall be filed with the Secretary of State: *Provided*, That the capital stock of any such bank may be increased at any time by a vote of two-thirds of its shareholders with the approval of the Comptroller of the Currency and that the capital stock of any such bank which exceeds two million dollars may be reduced at any time to the sum of two million dollars by the vote of shareholders owning two-thirds of the capital.

That every banking corporation formed pursuant to the provisions of this section shall for a period of twenty years from the date of the execution of its organization certificate be a body corporate, but shall not be authorized to receive deposits in the United States nor transact any domestic business not necessarily related to the business being done in foreign countries or in the dependencies of the United States. Such banking corporations shall have authority to make acceptances, buy and sell bills of exchange, or other commercial paper relating to foreign business, and to purchase and sell securities, including securities of the United States or of any State in the Union. Each banking corporation organized under the provisions of this section shall have power to establish and maintain for the transaction of its business

Federal Reserve Act

a branch or branches in foreign countries, their dependencies, or the dependencies of the United States at such places and under such regulations as its board of directors may deem expedient.

A majority of the shares of the capital stock of such banking corporation shall be held and owned by citizens of the United States or corporations chartered under the laws of the United States or of any State of the Union, and a majority of the members of the board of directors of such banking corporations shall be citizens of the United States. Each director shall own in his own right at least one hundred shares of the capital stock of the banking corporation of which he is a director.

Whenever the Comptroller shall become satisfied of the insolvency of any such banking corporation he may appoint a receiver who shall proceed to close up such corporation in the same manner in which he would close a national bank, the disposition of the assets of the branches to be subject to any special provisions of the laws of the country under whose jurisdiction such assets are located.

The annual meeting of every such banking corporation shall be held at its home office in the United States, and every such banking corporation shall keep at its home office books containing the names of all stockholders of such banking corporation and members of its board of directors, together with copies of the reports furnished by it to the Comptroller of the Currency exhibiting in detail and under appropriate heads the resources and liabilities of the banking corporation. Every such banking corporation shall make reports to the Comptroller of the Currency at such times as he may require, and shall be subject to exami-

Federal Reserve Act

National Reserve Association Bill
(The Aldrich Bill)

nations when deemed necessary by the Comptroller of the Currency through examiners appointed by him; the compensation of such examiners to be fixed by the Comptroller of the Currency.

Any such banking corporation may go into liquidation and be closed by the vote of its shareholders owning two-thirds of its stock.

Any bank doing business in the United States and being the owner of stock in the National Reserve Association may subscribe to the stock of any banking corporation organized under the provisions of this section, but the aggregate of such stock held by any one bank shall not exceed ten per centum of the capital stock of the subscribing bank.

COMMENT:

The National Reserve Association Bill provides for the organization of banking corporations to operate in foreign countries, the stock of which may be owned by member banks.

Federal Reserve Act

The Federal Reserve Act grants power to member banks to open branches in foreign countries.

By subsequent amendment, the power granted by Section 57 of the National Reserve Association Bill was also embodied in the Federal Reserve Act.

National Reserve Association Bill
(The Aldrich Bill)

RIGHT TO AMEND

SEC. 58. Congress reserves the right to alter or amend the provisions of this Act to take effect at the end of any decennial period from and after the organization of the National Reserve Association.

COMMENT:

M.M.S.

Federal Reserve Act

Right to Amend

Sec. 30. The right to amend, alter, or repeal this Act is hereby expressly reserved.

National Reserve Association Bill
(The Aldrich Bill)

Effect on Existing Provisions of Law

Sec. 59. All acts or parts of acts inconsistent with the provisions of this act are hereby repealed.

Comment:

M.M.S.

Federal Reserve Act

Effect on Existing Provisions of Law

Sec. 26. All provisions of law inconsistent with or superseded by any of the provisions of this Act are to that extent and to that extent only hereby repealed.

APPENDIX TO CHAPTER VIII

Below are printed Sections 6, 7, 17, 20, and 38 of the National Reserve Association Bill dealing primarily with the organization and powers of the proposed local associations, also Section 12 of the Federal Reserve Act dealing with the Advisory Council. There are no comparable provisions regarding these matters in the Federal Reserve Act and the National Reserve Association Bill. These sections are reproduced here because they are deemed essential for a complete understanding of the two measures. A few sections of the National Reserve Association Bill and the Federal Reserve Act have been omitted from the above juxtaposition because they deal with extraneous matter or matter not pertinent to the present comparison.

National Reserve Association Bill

(*The Aldrich Bill*)

LOCAL ASSOCIATIONS

SEC. 6. All subscribing banks within a district shall be grouped by the organization committee or after organization, by the National Reserve Association, into local associations of not less than ten banks, with an aggregate capital and surplus of at least five million dollars, for the purposes hereinafter prescribed: *Provided*, That the territory included in each association shall be contiguous and that in apportioning the territory due regard shall be had for the customary course of business and for the convenience of the banks forming the association: *Provided further*, That in apportioning the territory to local associations comprising a district every bank and all of the territory within said district shall be located within the boundaries of some local association: *And provided further*, That every subscribing bank shall become a member only of the local association of the territory in which it is situated.

The banks uniting to form a local association shall, by their presidents or vice presidents, under authority from the board of directors, execute a certificate in triplicate setting forth the name of the association, the names of the banks composing it, its principal place of business, its territorial limits, and the purposes for which it is organized. One copy of this certificate shall be filed with the Comptroller of the Currency, one copy shall be filed with the National Reserve Association, and one copy shall be filed with the branch of the National Reserve Association of the district in which the local association is included. Upon the filing of such certificates the local association therein named shall become a body corporate and by the name so designated may sue and be sued and exercise the powers of a body corporate for the purposes mentioned in this Act, and not otherwise.

The local associations in each district may be readjusted from time to time and new associations may be authorized by the directors of the National Reserve Association.

SEC. 7. Each local association shall have a board of directors, the number to be determined by the by-laws of the local association. Three-fifths of that number shall be elected by ballot cast by the representatives of the banks that are members of the local association, each bank having one representative and each representative one vote for each of the positions to be filled without reference to the number of shares which the bank holds in the National Reserve Association. Two-fifths of the whole number of directors of the local association shall be elected by the same representatives of the several banks that are members of the association, but in voting for these additional directors each representative shall be entitled to as many votes as the bank which he represents holds shares in the National Reserve Association: *Provided*, That in case forty per centum of the capital stock in any subscribing bank is owned directly or indirectly by any other subscribing bank, or in case forty per centum of the capital stock in each of two or more subscribing banks, being members of the same local association, is owned directly or indirectly by the same person, persons, copartnership, voluntary association, trustee, or corporation, then and in either of such cases, neither of such banks shall be entitled to vote separately, as a unit, or upon its stock,

except that such banks acting together, as one unit, shall be entitled to one vote, for the election of the board of directors of such local association. In no case shall voting by proxy be allowed. The authorized representative of a bank, as herein provided, shall be its president, vice president, or cashier.

Each director shall take an oath that he will, so far as the duty devolves upon him, diligently and honestly administer the affairs of such association and will not knowingly violate or willingly permit to be violated any of the provisions of this Act.

The directors originally elected shall hold office until the second Tuesday in February immediately following their election, and thereafter the directors shall be elected annually on that date and shall hold office for the term of one year.

The board of directors of the local association shall have authority to make by-laws, not inconsistent with law, which shall be subject to the approval of the National Reserve Association.

SEC. 17. The directors of each local association shall annually elect from their number a president, a vice president, and an executive committee, whose powers and duties shall be determined by the by-laws of the local association, subject, however, to the approval of the National Reserve Association.

SEC. 20. Any member of a local association may apply to such association for a guaranty of the commercial paper which it desires to rediscount at the branch of the National Reserve Association in its district. Any such bank receiving a guaranty from a local association shall pay a commission to the local association, to be fixed in each case by its board of directors. Expenses and losses in excess of commissions shall be met by an assessment of the members of the local association in proportion to the ratio which their capital and surplus bears to the aggregate capital and surplus of the members of the local association, which assessment shall be made by its board of directors, and the commission received for such guaranty, after the payment of expenses and possible losses, shall be distributed among the several banks of the local association in the same proportion. A local association shall have authority to require security from any bank offering paper for guaranty, or it may decline to grant the application. The total amount of guaranties by a local association to the

National Reserve Association shall not at any time exceed the aggregate capital and surplus of the banks forming the guaranteeing association.

SEC. 38. The National Reserve Association may purchase, acquire, hold, and convey real estate for the following purposes and for no other:

First. Such as shall be necessary for the immediate accommodation in the transaction of the business either of the head office or of the branches.

Second. Such as shall be mortgaged to it in good faith by way of security for debts previously contracted.

Third. Such as shall be conveyed to it in satisfaction of debts previously contracted in the course of its dealings.

Fourth. Such as it shall purchase at sales under judgments, decrees, or mortgages held by said association, or shall purchase to secure debts due to it.

But the National Reserve Association shall not hold the possession of any real estate under mortgage or the title and possession of any real estate purchased to secure any debts due to it for a longer period than five years.

Federal Reserve Act

FEDERAL ADVISORY COUNCIL

SEC. 12. There is hereby created a Federal Advisory Council, which shall consist of as many members as there are Federal Reserve districts. Each Federal reserve bank by its board of directors shall annually select from its own Federal reserve district one member of said council, who shall receive such compensation and allowances as may be fixed by his board of directors subject to the approval of the Federal Reserve Board. The meetings of said advisory council shall be held at Washington, District of Columbia, at least four times each year, and oftener if called by the Federal Reserve Board. The council may in addition to the meetings above provided for hold such other meetings in Washington, District of Columbia, or elsewhere, as

it may deem necessary, may select its own officers and adopt its own methods of procedure, and a majority of its members shall constitute a quorum for the transaction of business. Vacancies in the council shall be filled by the respective reserve banks, and members selected to fill vacancies, shall serve for the unexpired term.

The Federal Advisory Council shall have power, by itself or through its officers, (1) to confer directly with the Federal Reserve Board on general business conditions; (2) to make oral or written representations concerning matters within the jurisdiction of said board; (3) to call for information and to make recommendations in regard to discount rates, rediscount business, note issues, reserve conditions in the various districts, the purchase and sale of gold or securities by reserve banks, open-market operations by said banks, and the general affairs of the reserve banking system.

CHAPTER IX

AN ANALYTICAL COMPARISON OF THE ALDRICH BILL AND THE FEDERAL RESERVE ACT BASED ON THE JUXTAPOSITION OF TEXTS SHOWN IN CHAPTER EIGHT

The Aldrich Bill (*As introduced in the Senate*)	*The Federal Reserve Act* (*As signed by President Wilson*)

A. ORGANIZATION

1. Organization Committee Personnel

SECRETARY OF THE TREASURY	SECRETARY OF THE TREASURY
SECRETARY OF AGRICULTURE	SECRETARY OF AGRICULTURE
COMPTROLLER OF THE CURRENCY	COMPTROLLER OF THE CURRENCY
SECRETARY OF COMMERCE AND LABOR	

2. Districts

FIFTEEN	"NOT LESS THAN EIGHT NOR MORE THAN TWELVE"
"APPORTIONED WITH DUE REGARD TO THE CONVENIENT AND CUSTOMARY COURSE OF BUSINESS"	"APPORTIONED WITH DUE REGARD TO THE CONVENIENCE AND CUSTOMARY COURSE OF BUSINESS"

"NOT NECESSARILY ALONG STATE LINES"	"SHALL NOT NECESSARILY BE COTERMINOUS WITH ANY STATE OR STATES"
"MAY BE READJUSTED	"MAY BE READJUSTED
"AND NEW DISTRICTS . . . MAY FROM TIME TO TIME BE CREATED	"AND NEW DISTRICTS MAY FROM TIME TO TIME BE CREATED
"BY THE DIRECTORS OF THE NATIONAL RESERVE ASSOCIATION	"BY THE FEDERAL RESERVE BOARD,
"WHENEVER, IN THEIR OPINION, THE BUSINESS OF THE COUNTRY REQUIRES"	
	"NOT TO EXCEED TWELVE IN ALL"

3. Offices

CORPORATE "HEAD-OFFICE" IN WASHINGTON. INASMUCH, HOWEVER, AS ALL POWERS OF REDISCOUNT ARE DELEGATED TO THE BRANCHES THIS OFFICE MUST BE PRIMARILY ADMINISTRATIVE, EXCEPT FOR VOLUNTARY INVESTMENT OPERATIONS.	NO CORPORATE HEAD OFFICE AND NO PROVISION AS TO THE DOMICILE OF THE FEDERAL RESERVE BOARD EXCEPT THAT IT HOLD ITS FIRST MEETING IN WASHINGTON.
ONE BRANCH IN EACH DISTRICT.	ONE FEDERAL RESERVE BANK IN EACH DISTRICT.

4. Membership

ANY NATIONAL BANK OR ANY STATE BANK OR TRUST COMPANY, WHICH COMPLIES WITH CERTAIN REQUIREMENTS, *may* BECOME A MEMBER.	EVERY NATIONAL BANK *required* TO BECOME A MEMBER. STATE BANKS AND TRUST COMPANIES *may*, BY COMPLYING WITH CERTAIN REQUIREMENTS, BECOME MEMBERS.
STATE BANKS AND TRUST COMPANIES TO BE ELIGIBLE FOR MEMBERSHIP MUST, IN GENERAL, COMPLY WITH THE SAME REQUIREMENTS AS NATIONAL BANKS WITH REGARD TO CAPITAL, RESERVES, AND EXAMINATIONS.	STATE BANKS AND TRUST COMPANIES TO BE ELIGIBLE FOR MEMBERSHIP MUST, IN GENERAL, COMPLY WITH THE SAME REQUIREMENTS AS NATIONAL BANKS WITH REGARD TO CAPITAL, RESERVES, AND EXAMINATIONS.

5. Capital

"TWENTY PER CENTUM OF THE PAID-IN AND UNIMPAIRED *capital*" OF MEMBER BANKS.	SIX PER CENTUM OF THE PAID-UP *capital stock and surplus*" OF MEMBER BANKS.
"SHALL BE DIVIDED INTO SHARES OF ONE HUNDRED DOLLARS EACH"	"SHALL BE DIVIDED INTO SHARES OF $100 EACH.
"THE OUTSTANDING CAPITAL STOCK MAY BE INCREASED FROM TIME TO TIME	"THE OUTSTANDING CAPITAL STOCK SHALL BE INCREASED FROM TIME TO TIME
"AS SUBSCRIBING BANKS INCREASE THEIR CAPITAL	"AS MEMBER BANKS INCREASE THEIR CAPITAL STOCK AND SURPLUS

"OR AS ADDITIONAL BANKS BECOME SUBSCRIBERS	"OR AS ADDITIONAL BANKS BECOME MEMBERS,
"OR MAY BE DECREASED	"AND MAY BE DECREASED
"AS SUBSCRIBING BANKS REDUCE THEIR CAPITAL	"AS MEMBER BANKS REDUCE THEIR CAPITAL STOCK OR SURPLUS
"OR LEAVE THE ASSOCIATION BY LIQUIDATION."	"OR CEASE TO BE MEMBERS."
"FIFTY PER CENTUM OF THE SUBSCRIPTIONS TO THE CAPITAL STOCK OF THE NATIONAL RESERVE ASSOCIATION SHALL BE FULLY PAID IN"	FIFTY PER CENTUM OF THE SUBSCRIPTIONS SHALL BE PAID IN, ONE-THIRD UPON CALL OF THE ORGANIZATION COMMITTEE, ONE-THIRD WITHIN THREE MONTHS, AND ONE-THIRD WITHIN SIX MONTHS.
"THE REMAINDER OF THE SUBSCRIPTIONS OR ANY PART THEREOF	"THE REMAINDER OF THE SUBSCRIPTION, OR ANY PART THEREOF,
"SHALL BECOME A LIABILITY OF THE SUBSCRIBERS,	
"SUBJECT TO CALL AND PAYMENT THEREOF	"SHALL BE SUBJECT TO CALL
"WHENEVER NECESSARY TO MEET THE OBLIGATIONS OF THE NATIONAL RESERVE ASSOCIATION"	"WHEN DEEMED NECESSARY BY THE FEDERAL RESERVE BOARD.
"BEFORE SAID ASSOCIATION SHALL BE AUTHORIZED TO	"NO FEDERAL RESERVE BANK SHALL COMMENCE BUSINESS

COMMENCE BUSINESS TWO HUNDRED MILLION DOLLARS OF THE CAPITAL STOCK SHALL BE SUBSCRIBED AND ONE HUNDRED MILLION DOLLARS OF ITS CAPITAL SHALL BE PAID IN CASH."	WITH A SUBSCRIBED CAPITAL LESS THAN $4,000,000."

6. Incorporation, Charter, and Powers

UPON DULY MAKING AND FILING WITH THE COMPTROLLER OF THE CURRENCY THE PROPER CERTIFICATE *the* NATIONAL RESERVE ASSOCIATION SHALL BECOME A BODY CORPORATE AND AS SUCH SHALL HAVE POWER TO ADOPT AND USE A CORPORATE SEAL, MAKE CONTRACTS, SUE AND BE SUED, ELECT OR APPOINT OFFICERS, ADOPT BY-LAWS, ETC.	UPON DULY MAKING AND FILING WITH THE COMPTROLLER OF THE CURRENCY THE PROPER CERTIFICATE *each* FEDERAL RESERVE BANK SHALL BECOME A BODY CORPORATE AND AS SUCH SHALL HAVE POWER TO ADOPT AND USE A CORPORATE SEAL, MAKE CONTRACTS, SUE AND BE SUED, APPOINT BY ITS BOARD OF DIRECTORS OFFICERS AND EMPLOYEES, ADOPT BY-LAWS, ETC.
"HAVE SUCCESSION FOR A PERIOD OF FIFTY YEARS"	"HAVE SUCCESSION FOR A PERIOD OF TWENTY YEARS . . .
	"UNLESS IT IS SOONER DISSOLVED BY AN ACT OF CONGRESS, OR UNLESS ITS FRANCHISE BECOMES FORFEITED BY SOME VIOLATION OF LAW"

B. MANAGEMENT

1. Board of Directors of Operating Offices

NOT LESS THAN TWELVE IN ADDITION TO THE MANAGER WHO SHALL BE A MEMBER EX OFFICIO	NINE
ELECTED BY VOTE OF REPRESENTATIVES OF THE LOCAL ASSOCIATIONS: THREE-SIXTHS—BY VOTE OF EACH REPRESENTATIVE WITHOUT REGARD TO THE CAPITAL OF THE BANKS FORMING THE ASSOCIATION AND TWO-SIXTHS—BY VOTE OF THE SAME REPRESENTATIVES IN PROPORTION TO THE BANKS' CAPITAL	ONE-THIRD (CLASS A) ELECTED BY EACH MEMBER BANK CASTING ONE VOTE WITHOUT REGARD TO ITS CAPITAL AND SURPLUS. THESE SHALL BE "REPRESENTATIVE OF THE STOCK-HOLDING BANKS"
ONE-SIXTH ELECTED BY THE "DIRECTORS ALREADY ELECTED." THESE "SHALL FAIRLY REPRESENT THE AGRICULTURAL, COMMERCIAL, INDUSTRIAL, AND OTHER INTERESTS OF THE DISTRICT, AND SHALL NOT BE OFFICERS, NOR, WHILE SERVING, DIRECTORS OF BANKS, TRUST COMPANIES, INSURANCE COMPANIES, OR OTHER FINANCIAL INSTITUTIONS"	ONE-THIRD (CLASS B) ELECTED AS ABOVE BUT "WHO AT THE TIME OF THEIR ELECTION SHALL BE ACTIVELY ENGAGED IN THEIR DISTRICT IN COMMERCE, AGRICULTURE OR SOME OTHER INDUSTRIAL PURSUIT" AND WHO, WHILE A DIRECTOR, SHALL NOT "BE AN OFFICER, DIRECTOR, OR EMPLOYEE OF ANY BANK"

	ONE-THIRD (CLASS C) APPOINTED BY THE FEDERAL RESERVE BOARD. WHILE SERVING NONE OF THESE SHALL "BE AN OFFICER, DIRECTOR, EMPLOYEE, OR STOCKHOLDER OF ANY BANK."
"NO MEMBER OF ANY NATIONAL OR STATE LEGISLATIVE BODY SHALL BE A DIRECTOR"	"NO SENATOR OR REPRESENTATIVE IN CONGRESS SHALL BE . . . AN OFFICER OR DIRECTOR."
AFTER THE FIRST ELECTION ALL DIRECTORS SHALL BE ELECTED FOR A TERM OF THREE YEARS, THE TENURE OF OFFICE OF ONE-THIRD OF EACH GROUP EXPIRING EACH YEAR	AFTER THE FIRST ELECTION ALL DIRECTORS SHALL BE ELECTED FOR A TERM OF THREE YEARS, THE TENURE OF OFFICE OF ONE-THIRD OF EACH GROUP EXPIRING EACH YEAR.
THE MANAGER OF THE BRANCH, APPOINTED BY THE GOVERNOR WITH THE APPROVAL OF THE EXECUTIVE COMMITTEE OF THE NATIONAL RESERVE ASSOCIATION AND THE BOARD OF DIRECTORS OF THE BRANCH, SHALL BE THE CHAIRMAN OF THE BOARD.	ONE OF THE CLASS C DIRECTORS SHALL BE DESIGNATED BY THE FEDERAL RESERVE BOARD AS CHAIRMAN OF THE BOARD.

2. Central Board

In this part of the analysis, the Executive Committee of the National Reserve Association is compared with the Federal Reserve Board and the Board of Directors of the National

Reserve Association is compared with the Federal Advisory Council. The reason for this is that the Executive Committee was to be the actual operating body of the Association. The full Board, consisting of forty-six members, could not, of course, have functioned as the active managerial board. Rather it is to be assumed that it, just as similar boards of European central banks, would limit its activities—aside from electing the Executive Committee—to the formal ratification of the actions of the Executive Committee. The Federal Advisory Council is placed alongside of the Board of Directors of the Association, as representing the country at large versus the central office, but attention is drawn to the very striking difference between them, namely, that the Federal Advisory Council is purely advisory with no power whatsoever to enforce its opinions.

a. Executive Committee	*a.* Federal Reserve Board
SHALL CONSIST OF FIVE MEMBERS ELECTED BY THE BOARD OF DIRECTORS OF THE NATIONAL RESERVE ASSOCIATION FROM AMONG THEIR OWN MEMBERS AND THE GOVERNOR AND THE TWO DEPUTY GOVERNORS OF THE ASSOCIATION AND THE COMPTROLLER OF THE CURRENCY AS MEMBERS EX OFFICIO.	SHALL CONSIST OF FIVE MEMBERS, APPOINTED BY THE PRESIDENT OF THE UNITED STATES BY AND WITH THE ADVICE AND CONSENT OF THE SENATE; THE SECRETARY OF THE TREASURY AND THE COMPTROLLER OF THE CURRENCY TO SERVE AS MEMBERS EX OFFICIO
"NOT MORE THAN ONE OF THE ELECTED MEMBERS SHALL BE CHOSEN FROM ANY ONE DISTRICT"	"IN SELECTING THE FIVE APPOINTIVE MEMBERS . . . NOT MORE THAN ONE . . . SHALL BE SELECTED FROM ANY ONE FEDERAL RESERVE DISTRICT"

(FIFTEEN OF THE ENTIRE BOARD MUST BE REPRESENTATIVE OF THE AGRICULTURAL, COMMERCIAL, INDUSTRIAL, AND OTHER INTERESTS OF THE DISTRICTS)	"THE PRESIDENT SHALL HAVE DUE REGARD TO A FAIR REPRESENTATION OF THE DIFFERENT COMMERCIAL, INDUSTRIAL AND GEOGRAPHICAL DIVISIONS OF THE COUNTRY"
	"AT LEAST TWO SHALL BE PERSONS EXPERIENCED IN BANKING OR FINANCE"
"NO MEMBER OF ANY NATIONAL OR STATE LEGISLATIVE BODY SHALL BE A DIRECTOR"	"NO SENATOR OR REPRESENTATIVE IN CONGRESS SHALL BE A MEMBER"
THE ABOVE NAMED FIFTEEN MEMBERS "SHALL NOT BE OFFICERS NOR, WHILE SERVING, DIRECTORS OF BANKS, TRUST COMPANIES, INSURANCE COMPANIES, OR OTHER FINANCIAL INSTITUTIONS"	MEMBERS "SHALL BE INELIGIBLE DURING THE TIME THEY ARE IN OFFICE AND FOR TWO YEARS THEREAFTER TO HOLD ANY OFFICE, POSITION, OR EMPLOYMENT IN ANY MEMBER BANK"
THE GOVERNOR "SHALL BE EX OFFICIO CHAIRMAN"	"THE SECRETARY OF THE TREASURY SHALL BE EX OFFICIO CHAIRMAN"
THE GOVERNOR "SHALL BE SELECTED BY THE PRESIDENT OF THE UNITED STATES FROM A LIST OF NOT LESS THAN THREE SUBMITTED TO HIM BY THE BOARD OF DIRECTORS"	ONE OF THE FIVE APPOINTIVE MEMBERS "SHALL BE DESIGNATED BY THE PRESIDENT AS GOVERNOR AND ONE AS VICE GOVERNOR"
AFTER THE FIRST APPOINTMENTS THE TENURE OF OFFICE SHALL BE THREE YEARS, EX-	AFTER THE FIRST APPOINTMENTS THE TENURE OF OFFICE SHALL BE TEN YEARS, UNLESS

CEPT FOR THE EX OFFICIO MEMBERS. THE GOVERNOR SHALL HOLD OFFICE FOR TEN YEARS AND THE DEPUTY GOVERNORS FOR SEVEN YEARS.

b. Board of Directors

THE BOARD OF DIRECTORS OF EACH BRANCH SHALL ELECT TWO DIRECTORS TO THE CENTRAL BOARD. ONE OF THESE IN EACH INSTANCE SHALL FAIRLY REPRESENT THE AGRICULTURAL, COMMERCIAL, INDUSTRIAL, AND OTHER INTERESTS OF THE DISTRICT, AND SHALL NOT, WHILE SERVING, BE AN OFFICER OR DIRECTOR OF ANY OTHER FINANCIAL INSTITUTION.

FOR THE ELECTION OF NINE ADDITIONAL MEMBERS THE BOARD OF DIRECTORS OF EACH BRANCH SHALL ELECT A "VOTING REPRESENTATIVE" WHO SHALL CAST A NUMBER OF VOTES EQUAL TO THE NUMBER OF SHARES IN THE ASSOCIATION HELD BY THE BANKS IN THE BRANCH WHICH HE REPRESENTS. NOT MORE THAN ONE OF THE DIRECTORS OF THIS GROUP SHALL COME FROM ANY ONE DISTRICT.

SOONER REMOVED BY THE PRESIDENT, EXCEPT FOR THE EX OFFICIO MEMBERS.

b. Federal Advisory Council

THE BOARD OF DIRECTORS OF EACH FEDERAL RESERVE BANK SHALL ELECT ONE MEMBER

FINALLY, THERE SHALL BE SEVEN EX OFFICIO MEMBERS, NAMELY: THE GOVERNOR AND TWO DEPUTY GOVERNORS OF THE ASSOCIATION, THE SECRETARIES OF THE TREASURY, AGRICULTURE, COMMERCE AND LABOR, AND THE COMPTROLLER OF THE CURRENCY.

"THE EXECUTIVE COMMITTEE SHALL HAVE ALL THE AUTHORITY WHICH IS VESTED IN THE BOARD OF DIRECTORS, EXCEPT THE POWER OF NOMINATION, APPOINTMENT, AND REMOVAL OF THE GOVERNOR AND DEPUTY GOVERNORS AND EXCEPT SUCH AS MAY BE SPECIFICALLY DELEGATED BY THE BOARD TO OTHER COMMITTEES OR TO THE EXECUTIVE OFFICERS, OR SUCH AS MAY BE SPECIFICALLY RESERVED OR RETAINED BY THE BOARD." (THAT IS, IT WAS EXPECTED THAT WHILE THE BOARD WOULD HAVE THE POWER TO ENFORCE ITS JUDGMENT, IT WOULD LIMIT ITSELF UNDER ORDINARY CONDITIONS TO A CONFIRMATORY AND ADVISORY CAPACITY.)

"THE FEDERAL ADVISORY COUNCIL SHALL HAVE POWER, BY ITSELF OR THROUGH ITS OFFICERS, (1) TO CONFER DIRECTLY WITH THE FEDERAL RESERVE BOARD ON GENERAL BUSINESS CONDITIONS; (2) TO MAKE ORAL OR WRITTEN REPRESENTATIONS CONCERNING MATTERS WITHIN THE JURISDICTION OF SAID BOARD;" (3) TO CALL FOR INFORMATION AND TO MAKE RECOMMENDATIONS IN REGARD TO DISCOUNT RATES, REDISCOUNT BUSINESS, NOTE ISSUES, RESERVE CONDITIONS IN THE VARIOUS DISTRICTS, THE PURCHASE AND SALE OF GOLD OR SECURITIES BY RESERVE BANKS, OPEN-MARKET OPERATIONS BY SAID BANKS, AND THE GENERAL AFFAIRS OF THE RESERVE BANKING SYSTEM."

3. Administrative Powers

In this section of the analysis, only a few of the more important powers of the Federal Reserve Board are compared with the powers of the Board of Directors of the National Reserve Association. Many of the powers and duties of the Federal Reserve Board as listed in the Federal Reserve Act have no counterpart in the Aldrich Bill because the difference in corporate organization made their enumeration unnecessary. Under the Federal Reserve Act, each Federal reserve bank is a corporate body, while the Federal Reserve Board, or central administrative unit, is an unincorporated group. The result of this type of structure is that the Federal Reserve Board does not automatically acquire those general powers of supervision and administration over the Federal reserve banks that it would have, were it the head office of a single legal entity and the Federal reserve banks merely branches. In other words, all the powers which are to be exercised by the Federal Reserve Board must be expressly conferred and listed in detail. In the Aldrich Bill, on the other hand, there is only one corporate body, the National Reserve Association, and the central board of directors may exercise complete and absolute power over the branches, unless such power is specifically denied. The two most important denials of absolute power are, first, that the right of rediscount must be exercised through the branches, and, secondly, that there must not be less than fifteen branches. The former is of great significance. It leaves for the head office only the general administration of the system and the exercise of those investment operations, such as the so-called open-market purchases, which can be performed satisfactorily only by having a uniform policy for the whole system. In general, one might say, both bills confer some specific and very similar powers and duties upon their respective systems, and that the Aldrich Bill specifies which of the normal corporate powers of a central board of

directors it desires to restrict and transfer to the branches, while, conversely, the Federal Reserve Act specifies which of the normal corporate powers of the branches (Federal reserve banks) it desires to restrict and transfer to the unincorporated central board.

(AN IMPLICIT POWER OF A HEAD OFFICE)	"TO EXERCISE GENERAL SUPERVISION OVER SAID FEDERAL RESERVE BANKS"
"IT SHALL BE THE DUTY OF THIS BOARD (OF EXAMINATION) TO CAREFULLY EXAMINE THE CONDITION AND THE BUSINESS OF THE NATIONAL RESERVE ASSOCIATION AND OF ITS BRANCHES . . . AT LEAST ONCE A YEAR."	"THE FEDERAL RESERVE BOARD SHALL, AT LEAST ONCE EACH YEAR, ORDER AN EXAMINATION OF EACH FEDERAL RESERVE BANK."
(AN IMPLICIT POWER OF A HEAD OFFICE)	"TO REQUIRE THE WRITING-OFF OF DOUBTFUL OR WORTHLESS ASSETS UPON THE BOOKS AND BALANCE SHEETS OF FEDERAL RESERVE BANKS,"
NO POWER OF REMOVAL OF DIRECTORS OF BRANCHES; MANAGERS OF BRANCHES MAY BE REMOVED BY THE GOVERNOR WITH THE APPROVAL OF THE EXECUTIVE COMMITTEE; POWER TO REMOVE THE OTHER OFFICERS IMPLICIT.	"TO SUSPEND OR REMOVE ANY OFFICER OR DIRECTOR OF ANY FEDERAL RESERVE BANK,"

(IMPLICIT DISCRETIONARY POWER OF THE ASSOCIATION)	"TO HAVE THE RIGHT TO DETERMINE OR DEFINE THE CHARACTER OF THE PAPER . . . ELIGIBLE FOR DISCOUNT," WITHIN THE MEANING OF THE ACT, BY FEDERAL RESERVE BANKS.
RATE OF DISCOUNT FIXED BY THE CENTRAL BOARD OF THE ASSOCIATION UNIFORMLY FOR THE UNITED STATES, NOT BY THE BRANCHES.	TO REVIEW AND DETERMINE THE RATE OF DISCOUNT ESTABLISHED BY FEDERAL RESERVE BANKS.
(PROBLEM COULD NOT ARISE SINCE THE ASSOCIATION, AS A SINGLE CORPORATION, WOULD OPERATE AS A UNIT IN SO FAR AS RESOURCES ARE CONCERNED.)	"TO PERMIT, OR, ON THE AFFIRMATIVE VOTE OF AT LEAST FIVE MEMBERS OF THE RESERVE BOARD TO REQUIRE FEDERAL RESERVE BANKS TO REDISCOUNT THE DISCOUNTED PAPER OF OTHER FEDERAL RESERVE BANKS AT RATES OF INTEREST TO BE FIXED BY THE FEDERAL RESERVE BOARD,"
(IMPLICIT DISCRETIONARY POWER OF THE ASSOCIATION)	TO PRESCRIBE THE RULES AND REGULATIONS GOVERNING THE PURCHASE AND SALE OF BANKERS' ACCEPTANCES, BILLS OF EXCHANGE, ETC., IN THE OPEN MARKET BY FEDERAL RESERVE BANKS.
"THE POWER OF REDISCOUNT AND DISCOUNT GRANTED TO THE NATIONAL RESERVE AS-	

SOCIATION BY SECTIONS TWENTY-SIX, TWENTY-SEVEN AND TWENTY-EIGHT OF THIS ACT SHALL IN EACH CASE BE EXERCISED THROUGH THE BRANCH IN THE DISTRICT IN WHICH THE BANK MAKING THE APPLICATION IS LOCATED" (SECTIONS REFERRED TO WILL BE FOUND UNDER C, 1)

C. REDISCOUNTING

1. Eligibility Requirements for Notes, Drafts, and Bills

INDORSEMENT OF A MEMBER BANK

INDORSEMENT OF A MEMBER BANK

WAIVER OF DEMAND, NOTICE AND PROTEST

"ARISING OUT OF COMMERCIAL TRANSACTIONS;

"ARISING OUT OF ACTUAL COMMERCIAL TRANSACTIONS;

"THAT IS, . . . ISSUED OR DRAWN FOR AGRICULTURAL, INDUSTRIAL, OR COMMERCIAL PURPOSES"

"THAT IS, . . . ISSUED OR DRAWN FOR AGRICULTURAL, INDUSTRIAL, OR COMMERCIAL PURPOSES,

"OR THE PROCEEDS OF WHICH HAVE BEEN USED, OR ARE TO BE USED, FOR SUCH PURPOSES."

"NOT INCLUDING NOTES OR BILLS ISSUED OR DRAWN FOR THE PURPOSE OF CARRYING STOCKS, BONDS, OR OTHER INVESTMENT SECURITIES."	"SHALL NOT INCLUDE NOTES, DRAFTS, OR BILLS COVERING MERELY INVESTMENTS OR ISSUED OR DRAWN FOR THE PURPOSE OF CARRYING OR TRADING IN STOCKS, BONDS, OR OTHER INVESTMENT SECURITIES, EXCEPT BONDS AND NOTES OF THE GOVERNMENT OF THE UNITED STATES."
"MUST HAVE A MATURITY OF NOT MORE THAN TWENTY-EIGHT DAYS" [1]	"MUST HAVE A MATURITY AT THE TIME OF DISCOUNT OF NOT MORE THAN NINETY DAYS; PROVIDED, THAT NOTES, DRAFTS, AND BILLS DRAWN OR ISSUED FOR AGRICULTURAL PURPOSES OR BASED ON LIVE STOCK" MAY HAVE A MATURITY "NOT EXCEEDING SIX MONTHS." [1]
"MUST HAVE BEEN MADE AT LEAST THIRTY DAYS PRIOR TO THE DATE OF REDISCOUNT"	
"AMOUNT REDISCOUNTED MUST AT NO TIME EXCEED THE CAPITAL OF REDISCOUNTING BANK"	

[1] The "first draft" of the Glass Bill provided that eligible paper should have a maturity of only thirty days, unless the cash reserve of the Federal reserve bank discounting the paper exceeded 50 per centum of its total outstanding demand liabilities, in which case it could discount paper with a maturity of not more than 120 days. (See Willis, *The Federal Reserve System*, p. 1542.)

"THE AGGREGATE OF SUCH NOTES AND BILLS BEARING THE SIGNATURE OR INDORSEMENT OF ANY ONE PERSON, COMPANY, FIRM, OR CORPORATION, REDISCOUNTED FOR ANY ONE BANK, SHALL AT NO TIME EXCEED TEN PER CENTUM OF THE UNIMPAIRED CAPITAL AND SURPLUS OF SAID BANK" (SEC. 26 N. R. A.)

"THE AGGREGATE OF SUCH NOTES AND BILLS BEARING THE SIGNATURE OR INDORSEMENT OF ANY ONE PERSON, COMPANY, FIRM OR CORPORATION REDISCOUNTED FOR ANY ONE BANK SHALL AT NO TIME EXCEED TEN PER CENTUM OF THE UNIMPAIRED CAPITAL AND SURPLUS OF SAID BANK; BUT THIS RESTRICTION SHALL NOT APPLY TO THE DISCOUNT OF BILLS OF EXCHANGE DRAWN IN GOOD FAITH AGAINST ACTUALLY EXISTING VALUES."

NOTES AND BILLS OF EXCHANGE HAVING MORE THAN TWENTY-EIGHT DAYS, BUT NOT EXCEEDING FOUR MONTHS, TO RUN, WHICH ARE GUARANTEED BY A "LOCAL" ASSOCIATION. (SEC. 27 N. R. A.)

THE DIRECT OBLIGATIONS OF A MEMBER BANK, INDORSED BY THE "LOCAL ASSOCIATION," IF IT IS SECURED BY "SATISFACTORY SECURITIES," "WHENEVER, IN THE OPINION OF THE GOVERNOR OF THE NATIONAL RESERVE ASSOCIATION, THE PUBLIC INTERESTS SO REQUIRE, SUCH OPINION TO BE CONCURRED IN BY THE EXECUTIVE COM-

MITTEE . . . AND TO HAVE THE DEFINITE APPROVAL OF THE SECRETARY OF THE TREASURY." IN NO CASE SHALL THE AMOUNT SO LOANED EXCEED THREE-FOURTHS OF THE VALUE OF THE SECURITIES. (SEC. 28 N. R. A.)

SEE NOTE BELOW[1]

2. Eligibility Requirements for Discounting Acceptances

"FROM A SUBSCRIBING BANK" ———————————

"OF BANKS OR ACCEPTORS OF UNQUESTIONED FINANCIAL RESPONSIBILITY" ———————————

"ARISING OUT OF COMMERCIAL TRANSACTIONS AS HEREINBEFORE DEFINED"

"BASED ON THE IMPORTATION OR EXPORTATION OF GOODS" (SEE ALSO THE PROVISIONS UNDER "OPEN MARKET")

[1] The "first draft," the "revised draft," the "first print," and the "Glass Bill as introduced in the House" all contained provisions for the rediscounting of direct obligations of member banks secured by "satisfactory securities." The following quotation is from the bill as introduced in the House (Willis, p. 1604):

"Whenever in the opinion of the Federal Reserve Board the public interest so requires, the Federal Reserve Board may authorize the reserve bank of the district to discount the direct obligations of member banks, secured by the pledge and deposit of satisfactory securities; but in no case shall the amount so loaned by a Federal reserve bank exceed three-fourths of the actual value of the securities so pledged or one-half of the paid-up and unimpaired capital of the member bank."

"HAVE NOT EXCEEDING NINETY DAYS TO RUN"	"HAVE A MATURITY AT TIME OF DISCOUNT OF NOT MORE THAN THREE MONTHS"
"BEAR THE INDORSEMENT OF THE SUBSCRIBING BANK SELLING THE SAME, WHICH INDORSEMENT MUST BE OTHER THAN THAT OF THE ACCEPTOR"	"INDORSED BY AT LEAST ONE MEMBER BANK"
	"THE AMOUNT OF ACCEPTANCES SO DISCOUNTED SHALL AT NO TIME EXCEED ONE-HALF THE PAID-UP CAPITAL STOCK AND SURPLUS OF THE BANK FOR WHICH THE REDISCOUNTS ARE MADE"

D. VOLUNTARY PURCHASES FROM MEMBERS OR IN THE OPEN MARKET

"PURCHASE FROM ITS SUBSCRIBING BANKS AND TO SELL,	"PURCHASE FROM MEMBER BANKS AND TO SELL,
"WITH OR WITHOUT ITS INDORSEMENT,	"WITH OR WITHOUT ITS INDORSEMENT,
"CHECKS OR BILLS OF EXCHANGE, ARISING OUT OF COMMERCIAL TRANSACTIONS AS HEREINBEFORE DEFINED,	"BILLS OF EXCHANGE ARISING OUT OF COMMERCIAL TRANSACTIONS, AS HEREINBEFORE DEFINED."
"PAYABLE IN SUCH FOREIGN COUNTRIES AS THE BOARD OF DIRECTORS OF THE NATIONAL RESERVE ASSOCIATION MAY DETERMINE.	

"THESE BILLS OF EXCHANGE MUST HAVE NOT EXCEEDING NINETY DAYS TO RUN,

"AND MUST BEAR THE SIGNATURES OF TWO OR MORE RESPONSIBLE PARTIES, OF WHICH THE LAST ONE SHALL BE THAT OF A SUBSCRIBING BANK."

"UNDER RULES AND REGULATIONS PRESCRIBED BY THE FEDERAL RESERVE BOARD,

"PURCHASE AND SELL IN THE OPEN MARKET, AT HOME OR ABROAD,

"EITHER FROM OR TO DOMESTIC OR FOREIGN BANKS, FIRMS, CORPORATIONS, OR INDIVIDUALS,

See "2. ELIGIBILITY REQUIREMENTS FOR ACCEPTANCES," ABOVE

"CABLE TRANSFERS AND BANKERS' ACCEPTANCES AND BILLS OF EXCHANGE OF THE KINDS AND MATURITIES BY THIS ACT MADE ELIGIBLE FOR REDISCOUNT,

"WITH OR WITHOUT THE INDORSEMENT OF A MEMBER BANK."

E. INVESTMENTS IN GOVERNMENT SECURITIES

"INVEST IN	"BUY AND SELL, AT HOME OR ABROAD,
"UNITED STATES BONDS;	"BONDS AND NOTES OF THE UNITED STATES,
"ALSO IN OBLIGATIONS	"AND BILLS, NOTES, REVENUE BONDS, AND WARRANTS,
"HAVING NOT MORE THAN ONE YEAR TO RUN,	"WITH A MATURITY FROM DATE OF PURCHASE OF NOT EXCEEDING SIX MONTHS,
	"ISSUED IN ANTICIPATION OF THE COLLECTION OF TAXES OR IN ANTICIPATION OF THE RECEIPT OF ASSURED REVENUES
"OF THE UNITED STATES	(SEE ABOVE)
"OR ITS DEPENDENCIES,	
"OR OF ANY STATE,	"BY ANY STATE,
	"COUNTY, DISTRICT, POLITICAL SUBDIVISION, OR MUNICIPALITY IN THE CONTINENTAL UNITED STATES, INCLUDING IRRIGATION, DRAINAGE AND RECLAMATION DISTRICTS,
"OR OF FOREIGN GOVERNMENTS."	

	"SUCH PURCHASES TO BE MADE IN ACCORDANCE WITH RULES AND REGULATIONS PRESCRIBED BY THE FEDERAL RESERVE BOARD."

F. GOLD TRANSACTIONS

"BOTH AT HOME AND ABROAD, TO DEAL IN GOLD COIN OR BULLION,	"TO DEAL IN GOLD COIN AND BULLION AT HOME OR ABROAD,
"TO MAKE LOANS THEREON,	"TO MAKE LOANS THEREON,
	"EXCHANGE FEDERAL RESERVE NOTES FOR GOLD, GOLD COIN, OR GOLD CERTIFICATES,
"AND TO CONTRACT FOR LOANS OF GOLD COIN OR BULLION,	"AND TO CONTRACT FOR LOANS OF GOLD COIN OR BULLION,
"GIVING THEREFOR, WHEN NECESSARY, ACCEPTABLE SECURITY,	"GIVING THEREFOR, WHEN NECESSARY, ACCEPTABLE SECURITY,
"INCLUDING THE HYPOTHECATION OF ANY OF ITS HOLDINGS OF UNITED STATES BONDS.	"INCLUDING THE HYPOTHECATION OF UNITED STATES BONDS OR OTHER SECURITIES WHICH FEDERAL RESERVE BANKS ARE AUTHORIZED TO HOLD."

G. FOREIGN AGENCIES

"TO OPEN AND MAINTAIN BANKING ACCOUNTS IN FOREIGN COUNTRIES	"TO OPEN AND MAINTAIN BANKING ACCOUNTS IN FOREIGN COUNTRIES,
	"APPOINT CORRESPONDENTS,
"AND TO ESTABLISH AGENCIES IN FOREIGN COUNTRIES	"AND ESTABLISH AGENCIES IN SUCH COUNTRIES WHERESOEVER IT MAY DEEM BEST
"FOR THE PURPOSE OF PURCHASING, SELLING, AND COLLECTING FOREIGN BILLS OF EXCHANGE,	"FOR THE PURPOSE OF PURCHASING, SELLING AND COLLECTING BILLS OF EXCHANGE,
"AND . . . TO BUY AND SELL, WITH OR WITHOUT ITS INDORSEMENT,	"AND TO BUY AND SELL WITH OR WITHOUT ITS INDORSEMENT,
"THROUGH SUCH CORRESPONDENTS OR AGENCIES,	"THROUGH SUCH CORRESPONDENTS OR AGENCIES,
"BILLS OF EXCHANGE ARISING OUT OF COMMERCIAL TRANSACTIONS,	"BILLS OF EXCHANGE ARISING OUT OF ACTUAL COMMERCIAL TRANSACTIONS
"WHICH HAVE NOT EXCEEDING NINETY DAYS TO RUN,	"WHICH HAVE NOT MORE THAN NINETY DAYS TO RUN
"AND WHICH BEAR THE SIGNATURES OF TWO OR MORE RESPONSIBLE PARTIES."	"AND WHICH BEAR THE SIGNATURE OF TWO OR MORE RESPONSIBLE PARTIES."

H. RESERVE REQUIREMENTS

1. For Member Banks against Demand Deposits

"NATIONAL BANKS IN DIFFERENT LOCALITIES SHALL MAINTAIN THE SAME PERCENTAGES OF RESERVE AGAINST DEMAND DEPOSITS AS IS NOW REQUIRED BY LAW," "BUT THE DEPOSIT BALANCE OF ANY SUBSCRIBING BANK IN THE NATIONAL RESERVE ASSOCIATION AND ANY NOTES OF THE NATIONAL RESERVE ASSOCIATION WHICH IT HOLDS MAY BE COUNTED AS THE WHOLE OR ANY PART OF ITS REQUIRED RESERVE"

BANKS IN CENTRAL RESERVE CITIES, 18 PER CENTUM; IN RESERVE CITIES, 15 PER CENTUM; COUNTRY BANKS, 12 PER CENTUM. IN EACH INSTANCE A STIPULATED PROPORTION MUST BE KEPT IN THE FEDERAL RESERVE BANK AND IN THE VAULT OF THE MEMBER BANK, WHILE THE BALANCE MAY BE KEPT IN EITHER PLACE AT THE OPTION OF THE MEMBER BANK.

2. For Member Banks against Time Deposits

NONE, EXCEPT FOR THIRTY DAYS PRECEDING THEIR MATURITY WHEN THEY SHALL "BE SUBJECT TO THE SAME RESERVE REQUIREMENTS AS DEMAND DEPOSITS"

FIVE PER CENTUM, TO BE HELD BETWEEN THE BANK'S OWN VAULT AND THE FEDERAL RESERVE BANK IN THE SAME PROPORTION AS FOR DEMAND DEPOSITS. (FOR THIRTY DAYS PRECEDING THEIR MATURITY THE REQUIREMENT WOULD BE THE SAME AS FOR DEMAND DEPOSITS.)

3. For the Central Institution

"ALL DEMAND LIABILITIES, INCLUDING DEPOSITS AND CIRCULATING NOTES, . . . SHALL BE COVERED TO THE EXTENT OF 50 PER CENTUM BY A RESERVE OF GOLD (INCLUDING FOREIGN GOLD COIN AND GOLD BULLION) OR OTHER MONEY OF THE UNITED STATES WHICH THE NATIONAL BANKS ARE NOW AUTHORIZED TO HOLD AS A PART OF THEIR LEGAL RESERVE."

"EVERY FEDERAL RESERVE BANK SHALL MAINTAIN RESERVES IN GOLD OR LAWFUL MONEY OF NOT LESS THAN THIRTY-FIVE PER CENTUM AGAINST ITS DEPOSITS AND RESERVES IN GOLD OF NOT LESS THAN FORTY PERCENTUM AGAINST ITS FEDERAL RESERVE NOTES IN ACTUAL CIRCULATION"

FEDERAL RESERVE BOARD AUTHORIZED TO "SUSPEND FOR A PERIOD NOT EXCEEDING THIRTY DAYS, AND FROM TIME TO TIME TO RENEW SUCH SUSPENSION FOR PERIODS NOT EXCEEDING FIFTEEN DAYS, ANY RESERVE REQUIREMENT"

"WHENEVER AND SO LONG AS SUCH RESERVE SHALL FALL AND REMAIN BELOW 50 PER CENTUM THE NATIONAL RESERVE ASSOCIATION SHALL PAY A SPECIAL TAX UPON THE DEFICIENCY . . . AS FOLLOWS: FOR EACH TWO AND ONE-HALF PER CENTUM OR FRACTION THEREOF THAT THE

"WHEN THE GOLD RESERVE HELD AGAINST FEDERAL RESERVE NOTES FALLS BELOW FORTY PER CENTUM, THE FEDERAL RESERVE BOARD SHALL ESTABLISH A GRADUATED TAX OF NOT MORE THAN ONE PER CENTUM PER ANNUM UPON SUCH DEFICIENCY UNTIL THE RESERVES FALL TO THIRTY-

RESERVE FALLS BELOW 50 PER CENTUM A TAX SHALL BE LEVIED AT THE RATE OF ONE AND ONE-HALF PER CENTUM PER ANNUM; *Provided further*, THAT NO ADDITIONAL CIRCULATING NOTES SHALL BE ISSUED WHENEVER AND SO LONG AS THE AMOUNT OF SUCH RESERVE FALLS BELOW THIRTY-THREE AND ONE-THIRD PER CENTUM OF ITS OUTSTANDING NOTES."

TWO AND ONE-HALF PER CENTUM, AND WHEN SAID RESERVE FALLS BELOW THIRTY-TWO AND ONE-HALF PER CENTUM, A TAX AT THE RATE INCREASINGLY OF NOT LESS THAN ONE AND ONE-HALF PER CENTUM PER ANNUM UPON EACH TWO AND ONE-HALF PER CENTUM OR FRACTION THEREOF THAT SUCH RESERVE FALLS BELOW THIRTY-TWO AND ONE-HALF PER CENTUM."

I. NOTE ISSUES

"ALL NOTE ISSUES . . . SHALL AT ALL TIMES BE COVERED BY LEGAL RESERVES TO THE EXTENT" OF FIFTY PER CENTUM "AND BY NOTES OR BILLS OF EXCHANGE ARISING OUT OF COMMERCIAL TRANSACTIONS AS HEREINBEFORE DEFINED OR OBLIGATIONS OF THE UNITED STATES"

SHALL BE COVERED BY NOT LESS THAN FORTY PER CENTUM IN GOLD PLUS ONE HUNDRED PER CENTUM OF "NOTES AND BILLS ACCEPTED FOR REDISCOUNT"

"SHALL BE OBLIGATIONS OF THE UNITED STATES"

"SHALL CONSTITUTE A FIRST LIEN UPON ALL ITS ASSETS"

"FIRST AND PARAMOUNT LIEN ON ALL THE ASSETS OF SUCH BANK"

FEDERAL RESERVE BANKS SHALL PAY SUCH RATE OF INTEREST ON THE NOTES AS MAY BE ESTABLISHED BY THE FEDERAL RESERVE BOARD.

FEDERAL RESERVE BOARD MAY REFUSE TO FURNISH NOTES TO A FEDERAL RESERVE BANK

"ANY NOTES . . . IN CIRCULATION . . . IN EXCESS OF NINE HUNDRED MILLION DOLLARS WHICH ARE NOT COVERED BY AN EQUAL AMOUNT OF LAWFUL MONEY, GOLD BULLION, OR FOREIGN GOLD COIN HELD BY SAID ASSOCIATION, SHALL PAY A SPECIAL TAX AT THE RATE OF ONE AND ONE-HALF PER CENTUM PER ANNUM, AND ANY NOTES IN EXCESS OF ONE BILLION TWO HUNDRED MILLION DOLLARS NOT SO COVERED SHALL PAY A SPECIAL TAX AT THE RATE OF FIVE PER CENTUM PER ANNUM: *Provided*, THAT IN COMPUTING SAID AMOUNTS . . . THE AGGREGATE AMOUNT OF ANY NATIONAL BANK NOTES THEN OUTSTANDING SHALL BE INCLUDED"

"THE CIRCULATING NOTES OF THE NATIONAL RESERVE AS-

FEDERAL RESERVE NOTES "SHALL BE RECEIVABLE BY ALL

SOCIATION SHALL BE RECEIVED AT PAR IN PAYMENT OF ALL TAXES, EXCISES, AND OTHER DUES TO THE UNITED STATES . . . AND FOR ALL OBLIGATIONS DUE TO ANY BANK OR TRUST COMPANY."

NATIONAL AND MEMBER BANKS AND FEDERAL RESERVE BANKS, AND FOR ALL TAXES, CUSTOMS, AND OTHER PUBLIC DUES."

"SHALL BE REDEEMABLE IN LAWFUL MONEY ON PRESENTATION AT THE HEAD OFFICE OF SAID ASSOCIATION OR ANY OF ITS BRANCHES."

"SHALL BE REDEEMED IN GOLD ON DEMAND AT THE TREASURY DEPARTMENT OF THE UNITED STATES, IN THE CITY OF WASHINGTON, . . . OR IN GOLD OR LAWFUL MONEY AT ANY FEDERAL RESERVE BANK."

THE ACT OF MARCH 14TH, 1900, IS REAFFIRMED

THE ACT OF MARCH 14TH, 1900, IS REAFFIRMED

J. RETIREMENT OF NATIONAL BANK NOTES AND REFUNDING OF BONDS

"THE NATIONAL RESERVE ASSOCIATION SHALL, FOR A PERIOD OF ONE YEAR FROM THE DATE OF ITS ORGANIZATION, OFFER TO PURCHASE AT A PRICE NOT LESS THAN PAR AND ACCRUED INTEREST THE TWO PER CENTUM BONDS HELD BY SUBSCRIBING NATIONAL BANKS AND DEPOSITED TO SECURE THEIR CIRCULATING NOTES. . . . THE NA-

AFTER TWO YEARS FROM THE PASSAGE OF THE ACT AND FOR A PERIOD OF TWENTY YEARS THEREAFTER THE FEDERAL RESERVE BANKS MAY BE REQUIRED TO PURCHASE THE BONDS USED TO SECURE THE NATIONAL BANK CIRCULATION, TO AN AMOUNT NOT EXCEEDING $25,000,000 A YEAR. AGAINST THESE BONDS THE FEDERAL RESERVE BANKS MAY ISSUE

TIONAL RESERVE ASSOCIATION SHALL ISSUE . . . ITS OWN NOTES AS THE OUTSTANDING NOTES SECURED BY SUCH BONDS SO HELD SHALL BE PRESENTED FOR REDEMPTION . . . IT BEING THE POLICY OF THE UNITED STATES TO RETIRE AS RAPIDLY AS POSSIBLE, CONSISTENT WITH THE PUBLIC INTERESTS, BOND-SECURED CIRCULATION . . ." [1]

THEIR OWN NOTES. (FEDERAL RESERVE BANK NOTES)[1]

"UPON APPLICATION OF THE NATIONAL RESERVE ASSOCIATION THE SECRETARY OF THE TREASURY SHALL EXCHANGE THE TWO PER CENTUM BONDS . . . BEARING THE CIRCULATION PRIVILEGE PURCHASED FROM SUBSCRIBING BANKS FOR THREE PER CENTUM BONDS OF THE UNITED STATES WITHOUT THE CIRCULATION PRIVILEGE, PAYABLE AFTER FIFTY YEARS FROM THE DATE OF ISSUE." [1]

"UPON APPLICATION OF ANY FEDERAL RESERVE BANK, APPROVED BY THE FEDERAL RESERVE BOARD, THE SECRETARY OF THE TREASURY MAY ISSUE, IN EXCHANGE FOR UNITED STATES TWO PER CENTUM GOLD BONDS BEARING THE CIRCULATION PRIVILEGE, BUT AGAINST WHICH NO CIRCULATION IS OUTSTANDING, ONE-YEAR GOLD NOTES OF THE UNITED STATES WITHOUT THE CIRCULATION PRIVILEGE, TO AN AMOUNT NOT TO EXCEED ONE-HALF OF THE TWO PER CENTUM BONDS SO TENDERED FOR EXCHANGE, AND THIRTY-YEAR THREE PER CENTUM GOLD

[1] See footnote on next page.

BONDS WITHOUT THE CIRCULATION PRIVILEGE FOR THE REMAINDER . . ."[1]

K. CLEARING SYSTEM

"THE NATIONAL RESERVE ASSOCIATION MAY REQUIRE ANY LOCAL ASSOCIATION TO PERFORM SUCH SERVICES IN FACILITATING THE DOMESTIC EXCHANGES OF THE . . . ASSOCIATION AS THE PUBLIC INTERESTS MAY REQUIRE." ANY LOCAL ASSOCIATION MAY BY A VOTE OF THREE-FOURTHS OF ITS MEMBERS AND WITH THE APPROVAL OF THE NATIONAL RESERVE ASSOCIATION "EXERCISE SUCH OF THE POWERS AND FUNCTIONS OF A CLEARING HOUSE AS ARE NOT INCONSISTENT WITH THE PURPOSES OF THIS ACT"

"THE FEDERAL RESERVE BOARD . . . MAY AT ITS DISCRETION EXERCISE THE FUNCTIONS OF A CLEARING HOUSE FOR . . . FEDERAL RESERVE BANKS, OR MAY DESIGNATE A FEDERAL RESERVE BANK TO EXERCISE SUCH FUNCTIONS, AND MAY ALSO REQUIRE EACH BANK TO EXERCISE THE FUNCTIONS OF A CLEARING HOUSE FOR ITS MEMBER BANKS"

"IT SHALL BE THE DUTY OF THE NATIONAL RESERVE ASSOCIATION OR ANY OF ITS BRANCHES, UPON REQUEST,

"THE FEDERAL RESERVE BOARD SHALL MAKE AND PROMULGATE FROM TIME TO TIME REGULATIONS GOVERNING

[1] There are several additional provisions in regard to the retirement of the national bank notes and the refunding of the bonds bearing the circulation privilege but they are not included here because conditions have become so changed as to make retirement under existing provisions impracticable. The provisions are reprinted in full in the preceding chapter.

TO TRANSFER ANY PART OF THE DEPOSIT BALANCE OF ANY BANK HAVING AN ACCOUNT WITH IT TO THE CREDIT OF ANY OTHER BANK HAVING AN ACCOUNT WITH THE NATIONAL RESERVE ASSOCIATION. IF A DEPOSIT BALANCE IS TRANSFERRED FROM THE BOOKS OF ONE BRANCH TO THE BOOKS OF ANOTHER BRANCH, IT MAY BE DONE, UNDER REGULATIONS TO BE PRESCRIBED BY THE NATIONAL RESERVE ASSOCIATION, BY MAIL, TELEGRAPH, OR OTHERWISE, AT RATES TO BE FIXED AT THE TIME BY THE MANAGER OF THE BRANCH AT WHICH THE TRANSACTION ORIGINATES."

THE TRANSFER OF FUNDS AND CHARGES THEREFOR AMONG FEDERAL RESERVE BANKS AND THEIR BRANCHES . . . "

L. DEPOSITORS

"THE GOVERNMENT OF THE UNITED STATES AND BANKS OWNING STOCK IN THE NATIONAL RESERVE ASSOCIATION SHALL BE THE ONLY DEPOSITORS IN SAID ASSOCIATION,"

"ANY FEDERAL RESERVE BANK MAY RECEIVE FROM ANY OF ITS MEMBER BANKS, AND FROM THE UNITED STATES, DEPOSITS OF CURRENT FUNDS IN LAWFUL MONEY, NATIONAL BANK NOTES, FEDERAL RESERVE NOTES, OR CHECKS AND DRAFTS UPON SOLVENT MEMBER BANKS, PAYABLE UPON PRESENTATION;"

"THE NATIONAL RESERVE ASSOCIATION SHALL PAY NO INTEREST ON DEPOSITS."

M. FISCAL AGENCY RELATIONS

"THE NATIONAL RESERVE ASSOCIATION SHALL BE THE PRINCIPAL FISCAL AGENT OF THE UNITED STATES."

FEDERAL RESERVE BANKS "WHEN REQUIRED BY THE SECRETARY OF THE TREASURY, SHALL ACT AS FISCAL AGENTS OF THE UNITED STATES"

THE GENERAL FUNDS OF THE GOVERNMENT MUST BE DEPOSITED WITH THE ASSOCIATION.

DEPOSIT OF THE GENERAL FUNDS OF THE GOVERNMENT WITH THE FEDERAL RESERVE BANKS LEFT TO THE DISCRETION OF THE SECRETARY OF THE TREASURY.

N. EXEMPTION FROM TAXATION

"THE NATIONAL RESERVE ASSOCIATION AND ITS BRANCHES AND THE LOCAL ASSOCIATIONS SHALL BE EXEMPT FROM LOCAL AND STATE TAXATION EXCEPT IN RESPECT TO TAXES UPON REAL ESTATE"

"FEDERAL RESERVE BANKS, INCLUDING THE CAPITAL STOCK AND SURPLUS THEREIN, AND THE INCOME DERIVED THEREFROM SHALL BE EXEMPT FROM FEDERAL, STATE, AND LOCAL TAXATION, EXCEPT TAXES UPON REAL ESTATE."

O. PUBLICATION OF REPORTS

"SHALL MAKE A REPORT, SHOWING THE PRINCIPAL

THE "BOARD SHALL PUBLISH ONCE EACH WEEK A STATE-

ITEMS OF ITS BALANCE SHEET, . . . ONCE A WEEK. THESE REPORTS SHALL BE MADE PUBLIC."

MENT SHOWING THE CONDITION OF EACH FEDERAL RESERVE BANK AND A CONSOLIDATED STATEMENT FOR ALL FEDERAL RESERVE BANKS."

P. DIVISION OF EARNINGS

STOCKHOLDERS SHALL "RECEIVE AN ANNUAL DIVIDEND OF FOUR PER CENTUM ON THE PAID-IN CAPITAL, WHICH DIVIDEND SHALL BE CUMULATIVE."

STOCKHOLDERS SHALL "RECEIVE AN ANNUAL DIVIDEND OF SIX PER CENTUM ON THE PAID-IN CAPITAL STOCK, WHICH DIVIDEND SHALL BE CUMULATIVE."

ADDITIONAL NET EARNINGS SHALL BE USED FIRST, TO CREATE A CONTINGENT FUND EQUAL TO ONE PER CENTUM OF THE PAID-IN CAPITAL, BUT IN NO CASE TO EXCEED $2,000,000, AND, AFTER THIS, 50 PER CENTUM OF THE NET EARNINGS SHALL BE PAID INTO A SURPLUS FUND, TWENTY-FIVE PER CENTUM TO THE UNITED STATES AS A FRANCHISE TAX, AND TWENTY-FIVE PER CENTUM TO THE STOCKHOLDERS, PROVIDED THAT AFTER THE SURPLUS FUND SHALL AMOUNT TO TWENTY PER CENTUM OF THE PAID-IN CAPITAL AND THE STOCKHOLDERS HAVE RE-

ADDITIONAL NET EARNINGS SHALL BE PAID TO THE UNITED STATES AS A FRANCHISE TAX, EXCEPT THAT FIFTY PER CENTUM OF THEM SHALL BE PAID INTO A SURPLUS FUND UNTIL IT SHALL AMOUNT TO FORTY PER CENTUM OF THE PAID-IN CAPITAL.

CEIVED FIVE PER CENTUM ON THE PAID-IN CAPITAL, ALL EXCESS SHALL BE PAID TO THE UNITED STATES AS A FRANCHISE TAX.

THE NET EARNINGS RECEIVED BY THE UNITED STATES SHALL BE USED EITHER TO SUPPLEMENT THE GOLD RESERVE HELD AGAINST UNITED STATES NOTES (GREENBACKS) OR SHALL BE APPLIED TO THE REDUCTION OF THE OUTSTANDING BONDED INDEBTEDNESS OF THE UNITED STATES.

Q. RELATIONS WITH MEMBER BANKS

"ALL OF THE PRIVILEGES AND ADVANTAGES OF THE NATIONAL RESERVE ASSOCIATION SHALL BE EQUITABLY EXTENDED TO EVERY MEMBER BANK . . . . *Provided*, THAT THE NATIONAL RESERVE ASSOCIATION MAY SUSPEND A BANK FROM THE PRIVILEGES OF MEMBERSHIP FOR REFUSAL TO COMPLY WITH" THE REQUIREMENTS OF THE ACT, "OR FOR A FAILURE FOR THIRTY DAYS TO MAINTAIN ITS RESERVES, OR TO MAKE THE REPORTS REQUIRED BY THE FEDERAL RESERVE BANKS SHALL BE ADMINISTERED "WITHOUT DISCRIMINATION IN FAVOR OF OR AGAINST ANY MEMBER BANK OR BANKS AND SHALL, SUBJECT TO THE PROVISIONS OF LAW AND THE ORDERS OF THE FEDERAL RESERVE BOARD, EXTEND TO EACH MEMBER BANK SUCH DISCOUNTS, ADVANCEMENTS AND ACCOMMODATIONS AS MAY BE SAFELY AND REASONABLY MADE WITH DUE REGARD FOR THE CLAIMS AND DEMANDS OF OTHER MEMBER BANKS."

THIS ACT, OR FOR MISREPRESENTATION IN ANY REPORT OR EXAMINATION AS TO ITS CONDITION OR AS TO THE CHARACTER OR EXTENT OF ITS ASSETS OR LIABILITIES."	"IF AT ANY TIME IT SHALL APPEAR TO THE FEDERAL RESERVE BOARD THAT A MEMBER BANK HAS FAILED TO COMPLY WITH THE PROVISIONS OF THIS SECTION (9) OR THE REGULATIONS OF THE FEDERAL RESERVE BOARD, IT SHALL BE WITHIN THE POWER OF THE BOARD, AFTER HEARING, TO REQUIRE SUCH BANK TO SURRENDER ITS STOCK IN THE FEDERAL RESERVE BANK, . . . AND SUSPEND SAID BANK FROM FURTHER PRIVILEGES OF MEMBERSHIP . . . "
"ALL SUBSCRIBING BANKS SHALL . . . MAKE A REPORT MONTHLY, OR OFTENER IF REQUIRED, TO SAID ASSOCIATION SHOWING THE PRINCIPAL ITEMS OF THEIR BALANCE SHEETS."	
REPORTS OF NATIONAL AND STATE BANK EXAMINERS MAY BE ACCEPTED.	REPORTS OF NATIONAL AND STATE BANK EXAMINERS MAY BE ACCEPTED.
"THE NATIONAL RESERVE ASSOCIATION SHALL HAVE THE RIGHT AT ANY TIME TO EXAMINE OR CAUSE TO BE EXAMINED BY ITS OWN REPRESENTATIVES ANY SUBSCRIBING BANK"	"EVERY FEDERAL RESERVE BANK MAY, WITH THE APPROVAL OF THE FEDERAL RESERVE AGENT OR THE FEDERAL RESERVE BOARD, PROVIDE FOR SPECIAL EXAMINATION OF MEMBER BANKS WITHIN ITS DISTRICT."

R. ACCEPTANCES OF NATIONAL BANKS

"NATIONAL BANKS ARE HEREBY AUTHORIZED TO ACCEPT DRAFTS OR BILLS OF EXCHANGE DRAWN UPON THEM"	"ANY MEMBER BANK MAY ACCEPT DRAFTS OR BILLS OF EXCHANGE DRAWN UPON IT
"ARISING OUT OF COMMERCIAL TRANSACTIONS AS HEREINBEFORE DEFINED"	"AND GROWING OUT OF TRANSACTIONS INVOLVING THE IMPORTATION OR EXPORTATION OF GOODS
"HAVING NOT MORE THAN FOUR MONTHS TO RUN"	"HAVING NOT MORE THAN SIX MONTHS SIGHT TO RUN;
"PROPERLY SECURED"	———
"THE AMOUNT OF SUCH ACCEPTANCES OUTSTANDING SHALL NOT EXCEED ONE-HALF OF THE CAPITAL AND SURPLUS OF THE ACCEPTING BANK."	"BUT NO BANK SHALL ACCEPT SUCH BILLS TO AN AMOUNT EQUAL AT ANY TIME IN THE AGGREGATE TO MORE THAN ONE-HALF ITS PAID-UP CAPITAL STOCK AND SURPLUS."

S. REAL ESTATE LOANS BY NATIONAL BANKS

"UPON IMPROVED AND UNENCUMBERED REAL ESTATE"	UPON "IMPROVED AND UNENCUMBERED FARM LAND"
"SITUATED IN THE VICINITY OR IN THE TERRITORY DIRECTLY TRIBUTARY TO THE BANK"	"SITUATED WITHIN ITS FEDERAL RESERVE DISTRICT"
"NOT TO EXCEED FIFTY PER CENTUM OF THE ACTUAL VALUE OF THE PROPERTY"	NOT TO EXCEED "FIFTY PER CENTUM OF THE ACTUAL VALUE OF THE PROPERTY"

	"NO SUCH LOAN SHALL BE MADE FOR A LONGER TIME THAN FIVE YEARS"
AGGREGATE AMOUNT OF SUCH LOANS NOT TO EXCEED THIRTY PER CENTUM OF THE TIME DEPOSITS OF THE LENDING BANK	AGGREGATE AMOUNT OF SUCH LOANS MAY EQUAL ONE-THIRD OF THE TIME DEPOSITS OF THE LENDING BANK OR TWENTY-FIVE PER CENTUM OF ITS CAPITAL AND SURPLUS.
"THIS PRIVILEGE SHALL NOT BE EXTENDED TO BANKS ACTING AS RESERVE AGENTS FOR BANKS OR TRUST COMPANIES"	THIS PRIVILEGE GIVEN ONLY TO NATIONAL BANKS "NOT SITUATED IN A CENTRAL RESERVE CITY" AND THE "FEDERAL RESERVE BOARD SHALL HAVE POWER FROM TIME TO TIME TO ADD TO THE LIST OF CITIES IN WHICH NATIONAL BANKS SHALL NOT BE PERMITTED TO MAKE LOANS SECURED UPON REAL ESTATE"

T. FOREIGN TRADE ORGANIZATIONS

"BANKING CORPORATIONS FOR CARRYING ON THE BUSINESS OF BANKING IN FOREIGN COUNTRIES AND IN AID OF THE COMMERCE OF THE UNITED STATES WITH FOREIGN COUNTRIES AND TO ACT WHEN REQUIRED AS FISCAL AGENTS OF THE UNITED STATES IN SUCH COUNTRIES	(THE ONLY PROVISION FOR ORGANIZATIONS TO FACILITATE FOREIGN TRADE IN THE FEDERAL RESERVE ACT WAS THAT NATIONAL BANKS WITH A CAPITAL AND SURPLUS OF NOT LESS THAN $1,000,000 MIGHT, UPON THE APPROVAL OF THE FEDERAL RESERVE BOARD, ESTABLISH BRANCHES IN FOREIGN

MAY BE FORMED BY ANY NUMBER OF PERSONS, NOT LESS IN ANY CASE THAN FIVE"

COUNTRIES. SUBSEQUENT AMENDMENTS HAVE BROUGHT IT INTO AGREEMENT WITH THE PROVISIONS OF THE ALDRICH BILL QUOTED IN THE PARALLEL COLUMN.)

MUST HAVE A CAPITAL OF AT LEAST $2,000,000 WHICH MUST BE FULLY PAID-IN BEFORE THE CORPORATION IS AUTHORIZED TO COMMENCE BUSINESS.

"SHALL HAVE AUTHORITY TO MAKE ACCEPTANCES, BUY AND SELL BILLS OF EXCHANGE, OR OTHER COMMERCIAL PAPER RELATING TO FOREIGN BUSINESS, AND TO PURCHASE AND SELL SECURITIES" .

"SHALL HAVE POWER TO ESTABLISH AND MAINTAIN FOR THE TRANSACTION OF ITS BUSINESS A BRANCH OR BRANCHES IN FOREIGN COUNTRIES, THEIR DEPENDENCIES, OR THE DEPENDENCIES OF THE UNITED STATES."

CHAPTER X

THE LEGATEE OF THE ALDRICH BILL

A STUDY of the juxtaposition and the abstracts of the Aldrich Bill and the original Federal Reserve Act, as presented in the previous chapters, is likely to prove a surprise and a revelation to those of our readers who have been told by Mr. Glass that: "Aside from the technique familiar to all banking and currency schemes and excluding from the computation the nomenclature that inevitably applies to descriptions of commercial paper and discount operations of banks, there are few features of resemblance in the two plans. They differ in principle, in purpose, and in processes."[1] In other places in his book the Senator repeats this charge in substantially similar language. Such passages relating to Mr. Aldrich's work are in the main reprints of a speech delivered by Mr. Glass in the House of Representatives on September 7th, 1916. In this address he challenged his adversaries

> to show one-fourth or any part of the Aldrich bill not common to nearly every comprehensive coöperative banking scheme proposed in many years that has been transferred bodily or otherwise to the Federal Reserve Act impliedly or in text. Why do they not present their parallelisms? Why do they not specifically cite the identical features which would give a semblance of verity to their utterly unsubstantiated assertions? It is because they know they cannot do it, that they have never even attempted to justify their perversions by a presentation of the facts or by contrasting the various provisions of the two measures. . . . They differ in principle, in purpose, and in processes.[2]

[1] Glass, *ibid.*, p. 241.

[2] From Carter Glass's speech printed in the *Congressional Record* of September 7th, 1916.

A statement in a similar vein is found in Dr. Willis's *Federal Reserve System*, page 523:

> 1. The Federal Reserve Act was not a copy or derivative of any other single bill.
>
> 2. It had little or no relationship in principle to the so-called Aldrich bill, although it in various places made use of the Aldrich bill on matters relating to banking technique.
>
> 3. It was not derived from, or modeled after, or influenced even in the most remote way by other bills or proposals currently put forward from private sources, but, on the contrary, it was itself the pattern from which a host of imitators sought to copy.
>
> 4. It was not an "original proposal" in the sense that it embodied anything new in regard to banking principle, but on the contrary, it was the digested product of elaborate and careful study of European banking experience as adapted to American necessities and requirements.[1]

We hope that Senator Glass's desire to see the two bills presented in parallel columns has been satisfied by the juxtapositions in Chapters VIII and IX. For our own part we believe the evidence adduced from these comparisons will warrant the conclusion that there is a very distinct relationship between the two bills and that, instead of differing in "principle, purpose, and processes," they are surprisingly akin.

It seems unnecessary to argue the case in greater detail; a study of the evidence, however, suggests some interesting thoughts. If, in 1913, instead of the Federal Reserve Bill, the National Reserve Association Bill had been enacted, and if, on the strength of the experience furnished by the test of actual operation, it had been subjected to a process of gradual liberalization similar to that which the Federal Reserve Act has undergone, our investigation warrants the confident assertion that, in its main aspects, the National Reserve Association's weekly statement of assets and liabilities would probably resemble

[1] It is difficult to reconcile this statement with the one we quote on page 415 and with many other contradictory passages in Willis's book.

very closely the weekly consolidated statement issued to-day by the Federal Reserve System. The National Reserve Association's rediscount transactions would have been carried on by the branches, while open-market operations for the System would have been carried on by the central board, just as the rediscount operations to-day are carried on by the reserve banks, and just as to-day the open-market purchases and sales are being effected by the Executive Committee of Governors acting in coöperation with the Reserve Board for a combination of reserve banks.[1]

Like the Reserve System, the National Reserve Association would have provided a country-wide clearing system and an elastic note issue based upon bills rediscounted or purchased. While technically and legally the Federal reserve note is an obligation of the United States Government, in reality it is an obligation the sole actual responsibility for which rests on the reserve banks. These notes are issued and redeemed in response to the rediscount and investment operations of the reserve banks; they are, in practical effect, Federal reserve circulation guaranteed by the United States. The government could only be called upon to take them up after the reserve banks had failed. While radically different in theory, and while bound up with a mass of red tape in order to sustain the outward appearance of that theory, the note issue, as functioning to-day under the amended Federal Reserve Act, operates in the same manner as the note issue of the National Reserve Association would have functioned; and the same assertion may confidently be made with regard to reserves, as we have seen in the preceding chapter.

I have never joined those critics of the Federal Reserve Bill

[1] Except that the National Reserve Association, under the protection of a reasonable interest charge and other safeguards, would have permitted the absorption into its earning assets of a substantial portion of the checks in process of collection, the so-called "float," and, by doing so, would have called for correspondingly smaller amounts to be invested in government securities than the Federal Reserve System (See Chapter VIII, page 298, Comment).

who attacked the proposal of the issue of Federal reserve circulation by the United States Government as involving the issue of fiat money. On the contrary, I found myself charged with favoring the issue of fiat money when I advocated the issue of Federal reserve notes as the obligation of reserve banks, guaranteed by the United States. A letter written by me to a friend, later on prominently connected with the administration of the System, throws an amusing sidelight on the discussion (See Appendix Twenty-Six). The collateral evils indirectly following from the present form of the Federal reserve notes are graver than the direct consequences resulting from the adoption of the Bryan theory of the issue of bank currency by the government.

The main charge directed against the proposed National Reserve Association, as well as against my earlier United Reserve Bank of the United States, was that both planned the creation of "central banks"; in Mr. Glass's words, "central banks of the banks, by the banks and for the banks." There is no doubt that as a campaign slogan this war cry, with its open charge of "control by the interests," proved overwhelmingly successful in 1913. The Federal Reserve Act, with its structure of eight or twelve apparently autonomous regional banks, was politically by far the better, and in the long run the safer, plan. But our investigation has shown that the regional scheme, in order to become safe and effective, had to be conceived and administered, in the end, as a coördinated single central reserve system; while, conversely, the National Reserve Association, starting with the structure of a single central reserve system, in actual operation would have produced a regional system very nearly approaching that of the Federal Reserve Act. That the division of the Reserve System into a number of separate corporate units is in many respects more formal than actual may readily be conceived if one considers what the situation would be if all reserve bank stockholders were to exchange their stock in their local reserve

bank for that of one single reserve bank. The System, if such exchange were effected, would go on exactly as it does to-day and the stockholders, as a matter of fact, would not notice the difference. Where dividends are limited, where one reserve bank under the law may be forced to rediscount for another, there is, from the standpoint of investment, no substantial difference between the several reserve bank stocks. Stockholding in a reserve bank is important only with respect to the voting, rediscounting, and clearing privileges it confers upon the holders; and all of these privileges and protections could be conferred—as provided in the National Reserve Association and in the United Reserve Bank of the United States proposals—without the creation of organically separate corporations.

No doubt the voters in 1913 were led to believe that the Aldrich Plan envisaged a "central bank" in the European sense, and it is fair to assume that this view is still held to-day by many of the readers of Mr. Glass's broadsides against the one-time advocates of the Aldrich Plan. Few only will have observed the saving clause tucked away in a footnote of Mr. Glass's *Adventure in Constructive Finance* that "wherever the term 'central bank' occurs in this narrative it means a 'central bank of banks' dealing only with member banks of a system, and not a central bank in the European sense, transacting business with the public. No American banker advocated a central bank of the latter description."

It is amusing to note in this connection that when Mr. Glass's collaborator, Senator Owen, introduced the Federal Reserve Bill in the Senate, he used the following words in its praise and defense: "All of these considerations urge that the Federal reserve banks should be banks for banks, bankers' banks, and not a public bank competing with the banks for business." Here we have the admission of Mr. Glass's co-sponsor of the Federal Reserve Act that it provided a system "of the banks, by the banks and for the banks," with this main difference only: that the National Reserve Association

frankly provided for control by one central body, the banks of the country having the preponderating voice in appointing a central board on which the government had a minority representation, while the Federal Reserve Act provided for a division of powers and control between two separate groups, viz., the reserve banks, representing the member banks, and the Reserve Board, representing the government.

Brushing aside, then, the external differences affecting the "shells," we find the "kernels" of the two systems very closely resembling, and related to, one another. The outstanding and real difference between them is not so much one of form and substance, as of control. The closer we study the facts, the clearer it becomes that, behind the smoke screen of outward differences, neither side concerned in the controversy was capable of perceiving that the real point at issue between them was not the question of a central bank, because both parties in the end were advocating a central banking system rather than a central bank, but the problem of how it was to be controlled. In their effort to solve this all-important question, both sides, as we now are able to see, were sincere, but both sides went, it seems, too far in opposite directions. Both sides, therefore, failed. In our last chapter, we shall deal with this problem in so far as it affects the Reserve System. It may be timely, however, to dwell briefly, at this point, upon Senator Aldrich's efforts to solve it.

Whoever was to undertake the writing of a new banking law necessarily had to choose between the Scylla of preponderating business, or the Charybdis of preponderating government, control. To devise a practical scheme that would be ideally balanced was plainly impossible. That Senator Aldrich saw greater safety in a system in which the business element would predominate, and that in this direction he went too far, is frankly admitted. But Senator Aldrich sought to safeguard his plan by closely circumscribing the National Reserve Association's powers of dealing with individual member banks

and by broadly scattering the control all over the country.[1] Under his plan, no single interest could have predominated; and the possibilities of abuse, or excessive use, by an individual borrower were reduced to such a minimum, by the interposition of the local banking associations, that every imaginary incentive for the acquisition of control of a branch of the National Reserve Association was removed. In his speeches, the Senator himself constantly reiterated his desire and determination to eliminate the possibility that control could be acquired by any one interest or group. For instance, in a speech he delivered at Kansas City, on November 14th, 1911, he said:

> No plan . . . should be adopted where there is the slightest possibility that the organization or its business can be controlled by political influences or by any clique or combination in New York or elsewhere.

And we find these same thoughts expressed in another passage of that address as follows:

> So it would seem to be absolutely impossible, physically, that any organization could secure control of the National Reserve Association. But I agree fully with Professor Laughlin that the necessary steps, if any further are required, to prevent any domination of this character, should be incorporated in the report of the National Monetary Commission.

Few people realize that the Aldrich Plan gave New York, which at that time had 20 per cent of the banking capital of the country and 26 per cent of the country's banking resources, only four out of thirty-nine representatives on the central board of the National Reserve Association, or less than 10 per cent, while the Middle West, with 25 per cent of the banking resources, was allotted 41 per cent of the directorate, and the

[1] See Chapter VIII, page 220, Comment.

South, with 14 per cent of banking resources, 31 per cent. It has never been clear to the writer by what actual facts the charge could be sustained that the National Reserve Association was an "imperialistic scheme to seize the banking business of the United States."

As already stated, Senator Aldrich sought to buy freedom for the central board from political control at the price of imposing greater limitations upon the National Reserve Association's powers. It is interesting to note that early drafts of the Glass Bill, so long as they provided that the reserve banks and the business elements should have a substantial representation on the Reserve Board, contained similar provisions favoring the rediscounting of paper with short maturities. As control of the Board came to be vested in the government, these limitations were removed.

When comparing the Aldrich Bill and the Federal Reserve Act, one must bear in mind that the former never received the advantage of a full discussion in Congress, nor the benefit of the modifications suggested by the teachings of practical experience. It is safe to assume that the test of a Congressional debate would have strengthened the governmental influence in the administration of the Aldrich scheme and that, concurrent therewith, actual operation would soon have eliminated some of the cumbersome safeguards, such as the guarantee by the local banking associations, which had been devised primarily for the purpose of breaking down the apprehensions and prejudices which blocked the first pioneers' path—psychological obstructions which had to be overcome before any headway could be made.[1]

[1] In the author's opinion, Senator Glass entirely misses the mark when (on page 68 of his *Adventure in Constructive Finance*) he sums up the case of the Aldrich Bill versus the Federal Reserve Act by saying of the National Reserve Association Plan that "its distinguishing feature was centralization as against mobilization of the credits of the nation, the incentive and power of centralization being its normal state in contradistinction to mobilization." Mobilization of credit would have been substantially the same under the United Reserve Bank Plan, the Aldrich Bill, and the Federal Reserve Act.

On the other hand, some of the serious shortcomings of the Federal Reserve Act were not contained in the original Glass Bill, and Congressional debate and political necessities forced compromises and incongruities into the Federal Reserve Act from which the Aldrich Bill could hardly have remained free had it run the gamut of an acrimonious wrangle in both Houses. The Republican party, it must be remembered, had its radical elements no less than the Democrats, and nobody can tell what sacrifices would have become necessary to secure the coöperation of these radical elements had the Republican party remained in power. Certain it is that, during the long years of Republican domination, that party had not been capable of uniting upon a sound plan of banking reform.

When comparing the characteristic features of the two plans, I have often been reminded of two cathedrals, differing in detail, but showing in their main lines the imprint of ideas derived from the same school and period.[1] It is true, of course, that where the Republican architect designed fifteen chapels united by a solid dome, the Democratic craftsman drew a sketch for twelve chapels joined together by a cupola formed by an open network of girders. It is also true that those who later had to officiate under the open network dome found themselves exposed to the inclemencies of the weather, and that the hardships and discomforts of their position soon made them seek permission to close up some of the open spaces, to the extent that respect and reverence for the original architects would permit. It is profoundly to be regretted, however, that

[1] Dr. H. Parker Willis makes the following statement (page 428, *The Federal Reserve System*):

. . . "There was no necessary opposition between the ideas of the Aldrich bill in particular and the principles of a general nature which underlay the Federal Reserve Act. Both aimed at somewhat the same general object and used somewhat the same means for the attainment of that object. The Aldrich bill was vitiated by special interest concessions, by inadequacy, and by shortsightedness, but there was no reason why one who believed in the principles underlying the Aldrich measure should not have regarded the Federal Reserve Act as a further development and broadening of those same principles."

the draftsmen of the two plans show such scant consideration for each other. It is much to be regretted that Senator Aldrich's disappointment at his own failure, and his justified dismay at some of the features of the Federal Reserve Bill, made him a bitter, and possibly in parts an extreme, critic of the new plan. One finds it easier, however, to sympathize with Senator Aldrich, to whom the fruit of his labors was denied, than with Mr. Glass who, having enjoyed twelve years of practically unchallenged glory, saw fit to assail once more the record of his defeated opponent gone to his rest a decade before.

What we have in mind may perhaps best be illustrated by quoting some passages from Senator Glass's chapter "A Myth Destroyed."[1] The Senator writes as follows:

> On October 15, 1913, before the Academy of Political Science in New York City, Mr. Aldrich delivered an address on "Banking Reform in the United States." It occupies sixty-two printed pages in the record of proceedings, and was devoted, almost in its entirety, to an examination of the major provisions of the banking and currency bill passed by the House and subsequently enacted into law as the Federal Reserve Act. If anybody who is too simple to differentiate for himself the inherent contrarieties of *the Aldrich bill and the Federal Reserve Act* will read this address, he will quickly see that Mr. Aldrich did not make the inscrutable blunder of relating the one measure to the other. . . .
>
> Mr. Aldrich in that New York address assailed every essential feature of the Federal Reserve Act. . . .
>
> Summarizing his pronounced objections to the *federal reserve measure*, Mr. Aldrich, since acclaimed by his confused and beaten partizans as the real author of the bill he thus condemned, concluded his philippic in these words:
>
> "*I have tried to show that the bill has serious defects.* It appeals to the populists by adopting their plan of note issues; to the socialists by seeking to place the management of the most important private business of the country in the hands of

[1] *An Adventure in Constructive Finance*, Chapter XV, pp. 242–248.

the government; it seeks the support of bankers in great centres by its unexpected discrimination in their favour, but its dangerous doctrines and unwise methods do not appeal to the judgment of the American people. Its objectional features have neither the support of public opinion nor the approval of the banking fraternity. They are contrary to the teaching of economists and they are not supported by the judgment of practical men. It threatens to upset business and to produce the evil results it was projected to cure."

Thus, it is seen, Mr. Aldrich claimed no share, whatsoever, in the *federal reserve bill.* On the contrary, he ranged roughshod through every section of it. Not a fundamental provision was left untouched by his intemperate denunciation. And it is a poor tribute to his discernment and his frankness to suggest that he would have been foolish enough to excoriate bitterly before an audience of political economists a piece of legislation which had been patterned after his own production. The false claim, which Mr. Aldrich would have scorned, was first set up at an exigent moment in the presidential campaign of 1916 as a counterpoint to the boasts of an opposing party. It was promptly and searchingly controverted on the floor of the House of Representatives by the chairman of the Banking and Currency Committee of that body in a speech which challenged contradiction in any particular. No answer in general or in detail was made in that forum then; nor has any answer been made anywhere since that had the slightest responsibility attached to it. While the bare assertion itself now and then crops out, the remarkable address of Mr. Aldrich before the Academy of Political Science stands as a permanent and conclusive answer to the impudent claim. And it passes all comprehension, *in view of this authentic record*, how any person can expect to be believed when he asserts that *the Federal Reserve Act* is, in either a practical or theoretical sense, an imitation of the Aldrich currency scheme.[1]

The language above quoted from Senator Aldrich's speech would be apt to strike the reader as rather severe and con-

[1] The italics are mine —*Author.*

clusive—if, indeed, it applied to the Federal Reserve Act. But the reader will be amazed to learn that it does not. Senator Aldrich's speech of October 15th, 1913, dealt with Mr. Glass's earlier bill, as it passed the House and before it was drastically changed in becoming the Federal Reserve Act. No one conversant with the subject can read Senator Aldrich's speech without observing at once that he was dealing with this earlier draft of the Glass Bill. In order not to lengthen this chapter unduly, some extracts from Senator Aldrich's address are printed herein as Appendix Twenty-Seven. These extracts are extraordinarily illuminating in many respects. Suffice it to quote here two passages only, in which the Senator cites sections of the bill then before him. He points out first that:

> The Federal Reserve Board is given the power to determine each week, or as much oftener as required, the rate of discount to be charged by each reserve bank for each class of paper;

and, second, that:

> It will be remembered that the Federal Reserve Board consists of *three* members of the President's official family and four others to be appointed by the President and confirmed by the Senate.

The two sections just quoted clearly reveal the radical character of the earlier draft of the Glass Bill. It is easy to understand why Senator Aldrich, with these two sections before him, warned his hearers against a banking law that would have made the Reserve Board a hopelessly political body, with powers, plainly expressed, of dictating the discount policy of every reserve bank. The bill as then presented—with a Federal Reserve Board consisting of three Cabinet officers and four appointive members; with the "manager," as we have seen, subject to the supervision of the Secretary of the Treasury, and with power vested in such a Board in effect to fix the rediscount rates—embodied, indeed, a highly dangerous and objectionable proposal. Inasmuch as some of Senator Al-

drich's severest criticisms were levelled at these very phases of the Glass Bill, it is difficult to understand how Senator Glass could have remained unaware of the fact, or that he should have omitted to make it unmistakably clear to his readers, that Senator Aldrich was dealing with the *Glass Bill, as introduced in the House*, and not the Federal Reserve Act. When the Act had been passed, with important modifications of the sections quoted above, as described in a preceding chapter, Senator Aldrich wrote the following preface to the second edition of his said speech before the Academy of Political Science:

Note to Second Edition

> Since the following address was read before the Academy of Political Science, the "Federal Reserve Act" has become a law. The Senate and the Democratic caucus practically remodeled the measure, eliminating many of the objectionable features of the House Bill, and modifying provisions which had been subjected to severe criticism. The Act as finally adopted will, I believe, be accepted by the national banks with a view of seeking in good faith to make its operation a practical success and with the hope that defects may be cured by subsequent legislation.
>
> Whether the measure will meet the expectation of its friends will depend largely upon the manner in which it is administered. Its success will depend, first of all, upon the character and wisdom of the Federal Reserve Board, which is granted extraordinary powers of control over vast interests and intrusted with the decision of the intricate questions which are involved in the various provisions of the Act. Very much will also depend upon the conservative character of the management of the several Federal reserve banks.
>
> *The Act adopts many of the principles of the bill reported by the National Monetary Commission, as will be seen by a comparison of the texts of the two measures.*[1] Its authors concede that effective legislation for banking reform must embody provisions for the concentration and mobilization of

[1] The italics are mine—*Author.*

bank reserves through an organization of banks, and that member banks must be able through such an organization to maintain and replenish their reserves by a rediscount of commercial paper. Whether the organization provided by the Act will secure these results in a satisfactory manner can be ascertained only by experience.

If the loaning and note issuing power of the reserve banks is used to the fullest extent in ordinary times as anticipated by some of the authors of the Act, these institutions will be found powerless in case of emergency for purposes of support or protection. The adoption of this policy would naturally lead to an expansion of credit inflation of the currency, producing an appearance of prosperity and a boom in speculative prices, but the ultimate result would be disastrous.

N. W. A.

WARWICK, January, 1914

We must assume that Mr. Glass was not familiar with Senator Aldrich's "Note to the Second Edition"; it is impossible otherwise to understand how he could, by the omission of this note, have so entirely misrepresented Senator Aldrich's considered views concerning the Federal Reserve Act as finally passed. The omission is all the more unfortunate, since in reprinting Senator Aldrich's speech—we can only assume, unintentionally—an alteration was made which could not fail to increase the reader's confusion. A comparison of the text of Senator Aldrich's speech (Appendix Twenty-Seven) with the quotation given by Senator Glass will show that Senator Aldrich said:

> "I have tried to show that *the House bill* has serious defects . . . "[1]

while Mr. Glass's quotation makes this read:

> I have tried to show that *the bill* has serious defects.[1]

[1] Italics are mine—*Author.*

There is no intention to doubt Senator Glass's absolute sincerity when in his introduction[1] he solemnly declared that "At no point has there been attempt to twist the truth awry to confirm a preconceived conclusion"; but the unfortunate fact remains that his comment "Thus, it is seen, Mr. Aldrich claimed no share, whatsoever, in the *federal reserve bill*"[2] was bound to mislead the vast majority of his readers.

The passage of the Federal Reserve Act was a signal achievement and one for which the Democratic party could justly claim great credit. It is to be regretted, however, that men standing high in public estimation should have lessened their prestige and impaired their record by attempting to magnify their own accomplishments by belittling or denying altogether the value of their opponents' contributions.

For President Wilson, it will always remain a feat of the highest order to have succeeded in impressing his will upon a Democratic party in which confusion had prevailed for so many years and which included a powerful wing wedded to the wildest monetary and banking doctrines. With keen pertinacity he perceived and took advantage of the great opportunity the situation offered. He saw a country impatiently demanding banking reform, public opinion far advanced by a campaign of many years, and Congress prepared by Senator Aldrich's work for far-reaching action on scientific lines. It was clear to the President that the Democratic party in these circumstances could not afford to offer a substitute bill which would fail to measure up to the standards of the bill the National Monetary Commission had proposed. On the other hand, the Democratic banking reform bill, though in substance it might, if necessary, be the same, must at all hazards be different in appearance and, in form at least, must comply with some of the radical tenets of a powerful wing of the Democratic party. It was here that he showed his great

[1] *An Adventure in Constructive Finance*, Introduction, pp. 9–10.

[2] Glass, *ibid.*, p. 247; the italics are mine—*Author.*

genius as a political leader. He was quick enough to perceive that a system of regional banks required more substantial cohesion than the supervision of the Comptroller of the Currency, as proposed by Mr. Glass, and suggested, as the necessary link, an "altruistic" Board. As already stated, however, this suggestion was no extraordinary or original contribution. It was the logical sequel of a regional plan, and it was less astonishing that President Wilson reached this inevitable conclusion than that Messrs. Glass and Willis had managed to escape it. He threw Glass into consternation when he bought the support of the Bryan-Owen wing by permitting Federal reserve notes to be issued as the obligation of the United States; but, in doing so, in his own words, he "surrendered the shadow but saved the substance." He forced Glass to abandon banking representation upon the Reserve Board; and, having made it a purely governmental board, he once more conceded the shadow but saved the substance by inviting as many as three bankers among the five men to constitute the membership of the first Reserve Board.[1] Finally, he whipped his party into line to pass a bill which had taken, "lock, stock, and barrel," the technical clauses and, in substance, the most important parts of the very bill which his party platform had condemned, and which had been roundly denounced as a vicious snare from which the Federal Reserve Act was gloriously to save the country.

These compromises and stratagems secured a piece of legislation from which the country has derived blessings beyond measure; the United States owes President Wilson a debt of the deepest gratitude for the determination, courage, and sagacity with which he dealt with Congress and his own party leaders.

It was in the fight against the attacks by the wildest members of his own party and in breaking down selfish obstruction or demands from certain interests that Carter Glass proved a

[1] Of these, only two accepted.

tower of strength. Temperamentally cautious, Mr. Glass approached his problem with ideas more conservative than those of the President. Glass had read the banking reform literature published during the preceding years and evidently recognized what was good and valuable in the Aldrich Plan. The party platform, however, forbade a central bank plan, and thus Glass was driven to seek the same ends through a regional scheme. He started out with too generous a number of regional banks operating as entirely separate units. Gradually, as he wrestled with his problem, he became aware of the imperative necessity of linking these separate units together. Consciously or subconsciously, he finally evolved a central banking system; but for political reasons, and from habit, he continued to denounce central bank plans. With touching devotion and entire unselfishness, with grim tenacity and unfailing courage, he carried on the fight, a brilliant debater, witty and sarcastic, feared and respected. When Glass, after the passage of the Act, wrote: "If the country could know the true story of the struggle here it would realize that the public interest has been as well served by expunging the things which have been excluded from the Currency act, as by those which have been included,"[1] he threw a true light upon his contribution; even though one might add that the Reserve System would be stronger and safer to-day if, in this process of exclusion and inclusion, Mr. Glass in some respects had been more consistent and in others less tenacious.

When the Democrats took up the fight for currency reform, the idea had already triumphed; but their own party had to be conquered. In this struggle and in the accomplishment of having secured a great piece of financial legislation against the ignorance, prejudice, vagaries, and conceit at work within his own party ranks, Congressman Glass stood side by side and shared honors with the President.

[1] From letter to author, dated December 24th, 1913; see p. 140.

CHAPTER XI

THE REDISTRICTING INTERMEZZO

BEFORE presenting the conclusions to be drawn and the recommendations suggesting themselves from the historical and analytical account given in the preceding pages, it is necessary to devote our attention to Chapter Sixteen of Senator Glass's *An Adventure in Constructive Finance*. In this chapter Mr. Glass discusses the so-called "redistricting episode." This "episode," it will be remembered, occurred almost two years after the passage of the Federal Reserve Act. It involves, therefore, an intermezzo entirely unrelated to the matters which occasioned Senator Glass's articles, viz., the statements contained in Professor Seymour's *Intimate Papers of Colonel House* regarding Colonel House's contribution to the enactment of the Federal Reserve legislation and regarding the genesis of the Federal Reserve Act.

The tale of this "redistricting episode" pointedly dragged in and forming the closing word of the series of articles from the pen of Mr. Glass, as first published by a selected group of newspapers, constitutes a straight challenge to the members of the Board who played a part in that episode. But a refutation of Senator Glass's assertions is offered in this chapter not so much for the sake of establishing the true facts, as to indicate the necessity for the recommendations which are to follow.

The heading given by Senator Glass to Chapter Sixteen of his work is highly suggestive: [1]

[1] A liberal abstract of the chapter is reprinted in Appendix Twelve; readers are earnestly requested to peruse it, so that they may have it clearly in their minds when following our comments.

OLD GUARD'S LAST STAND

System Imperilled by Consolidationists—The President Angered—Reorganization Was Imminent—The Scheme Abandoned

Under this heading, four members of the first Board are described as dark conspirators, banded together to destroy the Reserve System with a view to paving the way for the ultimate establishment of a central bank. A similar picture of them may be found in Dr. Willis's book, *The Federal Reserve System*, Chapter XXXIV.

For a complete understanding of the subject, it is necessary to lead the reader back to the time when the Federal Reserve Act had been passed and when the time had come for the Organization Committee to enter upon its duties. It may be recalled that, while the Federal Reserve Act was under discussion, the business and banking communities had insistently urged that the number of reserve banks be reduced. The reader will also remember that the Glass Bill, after having started with twenty banks, finally provided for "not less than twelve," and that, under the pressure of public opinion, in "conference," the Senate provision of "not less than eight nor more than twelve" was finally accepted. In these circumstances, the country generally expected that the Organization Committee would begin by dividing the country into only eight districts, leaving to the Reserve Board the task of creating further Federal reserve districts if experience should prove additional districts to be necessary or desirable.

This expectation was all the more warranted as the evidence secured by the Organization Committee in their country-wide hearings was overwhelmingly in favor of the smaller number of reserve banks, only nine out of eighty-four witnesses favoring the larger number.[1] Senator Glass states that he favored the establishment of the System with only eight reserve banks

[1] My own testimony before the Organization Committee is given herein as Appendix Twenty-Eight.

as a beginning, and Dr. Willis indicates that he favored nine.

It was a shocking surprise, therefore, for the country and one of the worst blows the Reserve System could have received to have the Organization Committee force upon the country twelve reserve banks at the outset. There can be no doubt that for the incoming Board, this action made the administration of the System immeasurably harder, while it was certain to enhance the difficulty of securing men of outstanding character and ability for the administration of the smaller reserve banks. It was obvious that the smaller the bank, the less attractive would be an administrative position in it. A large number of banks, moreover, would increase the danger that they would exhibit a purely local and parochial point of view and that, in consequence, so far from assisting the Board in formulating a national policy, the small banks would stress their local views and, by so doing, confuse and resist the Board instead of aiding it.

The boundaries of the districts as drawn by the Organization Committee caused great dissatisfaction in a good many instances. In some cases, without doubt, these protests were fully justified, for the action of the Organization Committee had been extremely high-handed. For example, Jersey City and Hoboken, just a stone's throw from New York, had been allotted to the Philadelphia district, while some of the cities in southern Connecticut which, in fact, are suburbs of Greater New York, had been included in the Boston district.

Requests were soon filed with the Board for hearings on the applications of sections and localities desiring to be transferred from one district to another, while Pittsburgh and Baltimore claimed that they should be made Federal reserve cities instead of Cleveland and Richmond, respectively. The Board, having been charged by the Act with the unpleasant duty of reviewing the decisions of the Organization Committee, agreed that hearings should be held, but announced

that it would delay action until it had had an opportunity to observe the districts in actual operation for at least a year.

Any review of district boundaries, however, was certain to prove most embarrassing. Two of the three members of the Organization Committee—the Secretary of the Treasury and the Comptroller of the Currency—were *ex officio* members of the Board, and any readjustment undertaken by the Board necessarily involved a criticism and undoing of what these two colleagues had done. Moreover, the Governor of the Board, Mr. Hamlin, had formerly been Assistant Secretary of the Treasury, while Mr. John Skelton Williams, the Comptroller of the Currency and as such an *ex officio* member of the Board, had also been Assistant Secretary under Mr. McAdoo. Naturally, both Mr. Hamlin and Mr. Williams had a feeling of warm friendship for, and of loyal allegiance to, Mr. McAdoo, then the Chairman of the Reserve Board. It was certain, therefore, that three of the members of a Board of seven would try to block any drastic readjustments. The remaining four, however, had seen enough of the petty point of view resulting from a twelve-headed system, and of the difficulties of its administration, to convince them that, with regard to banking standards and efficiency of service, it would clearly be for the benefit of the country if the number of the reserve banks could be reduced.

Whether or not such reductions would be politically feasible, was another question. It should be stated, parenthetically, that, while members of the Board struggled individually with the task of how best to consolidate some of the districts, no specific plan was ever formulated by any committee. It was generally understood, however, that in the process of merging one Federal reserve district with another, no plan should be considered which—barring the small and unavoidable readjustments of the character mentioned above—might increase the power of New York. Any accentuation of New York's influence would be certain to lead to a misconstruction of

motives and would cause vicious attacks. A Committee was appointed to study the question and present a report; it consisted of F. A. Delano, Chairman, W. P. G. Harding, and the author.

The main question this Committee had under consideration was whether or not stronger and more satisfactory districts would be produced by combining some of the existing districts as, for instance, Minneapolis and Chicago. Indications had been received that Minneapolis itself felt that it would be served better as a branch organization of a larger Chicago district, than as the seat of an independent reserve bank. In a similar way, the questions of combining Dallas possibly with Kansas City, and Atlanta with Richmond or St. Louis, or of combining the three, and so forth, were discussed.

Plans along these lines were considered. But before they were permitted to take any definite form, the Committee sought positive instructions from the Board as to whether, in dealing with these applications of sections for transfer from one district to another, or with possible changes in connection with Federal reserve cities within given districts, they were to consider the existing twelve reserve banks as unalterable fixtures, or whether they were to approach the problem on the basis of a possible reduction of the number of Federal reserve districts.

Such consolidations, it should be quite clearly understood, would not have involved the dissolution of any of the twelve reserve bank organizations. Each would have continued to operate as before, except that those absorbed would have become branches and would, in consequence, deal with a parent office instead of adding to the complications of the Board by charging the latter with the duty of managing what in size and scope were, in fact, merely branches. The consolidation

[1] Certainly this was the writer's attitude. Governor W. P. G. Harding, in his book, *The Federal Reserve System*, Chapter IV, page 35, states that he favored a reduction of the number of the reserve banks from twelve to ten.

would have been effected by the member banks of, say, the Federal Reserve Bank of Minneapolis exchanging their stock for shares in the Chicago Federal Reserve Bank, just as was done where transfers of banks from one district to another were made.

The new branches created by such consolidation would each have had a board of directors of its own, such as that which to-day exists in Los Angeles, a city of over 1,200,000 inhabitants, which is a branch of San Francisco; and in Detroit, which is a branch of Chicago; and in Pittsburgh and Cincinnati, which are branches of Cleveland; and so forth. The service rendered by such branches is to all intents and purposes as satisfactory as that provided by the reserve bank proper. It is accordingly hard to understand why it should have been denounced as an act of injustice or violence to suggest that Dallas or Minneapolis should be served in a manner which has since proved satisfactory to other cities of much greater importance. The determined insistence upon the creation and preservation of "one-crop districts," which could not be expected to be self-sufficient, and which were likely to be governed by "one-crop" considerations, could hardly be justified, except on political grounds, in the face of the excellent example of a "composite district" furnished by the Federal reserve district of San Francisco, embracing all of California, Oregon, Washington, Idaho, Nevada, Utah, most of Arizona, and part of Montana.

Section 2 of the Federal Reserve Act reads as follows:

> As soon as practicable, the Secretary of the Treasury, the Secretary of Agriculture and the Comptroller of the Currency, acting as "The Reserve Bank Organization Committee," shall designate not less than eight nor more than twelve cities to be known as Federal reserve cities, and shall divide the continental United States, excluding Alaska, into districts, each district to contain only one of such Federal reserve cities. The determination of said organization committee shall not

> be subject to review except by the Federal Reserve Board when organized. . . . *The districts thus created may be readjusted and new districts may from time to time be created* by the Federal Reserve Board, not to exceed twelve in all. . . .[1]

From this, I am sure the lay reader will gain the impression that Congress here not only conferred upon the Reserve Board a right, but also imposed upon it a clear duty, to consider the question of districts in its broadest aspects.

On November 12th, 1915, the Committee brought the subject up for a preliminary discussion by the Board. In the absence of Mr. McAdoo, then ill at home, Governor Hamlin and Comptroller Williams objected to a preliminary discussion of the Committee's report and, in deference to their wishes, the debate was postponed until the following Monday. At the meeting which took place on that day, discussion was once more postponed for the reason that Mr. McAdoo was unable to attend because of work on his report to Congress. On Monday, November 22nd, when the Board reassembled and the Committee expected the subject to be taken up, it found itself confronted with a legal opinion of the Attorney General, which Governor Hamlin, acting without authority from the Board, in conjunction with, and at the instance of, Mr. McAdoo, had requested the President to secure.

The Attorney General's opinion was to the effect that the Reserve Board had no power to abolish any reserve bank. Thus, while the Board had deferred the discussion out of courtesy to Mr. McAdoo, the latter, together with the Board's governor, and the President, had combined, without the knowledge of the four appointive members of the Board, to forestall any debate by securing this opinion of the Attorney General.

About ten days later, on December 2nd, 1915, the Board's Committee addressed a report to the Board. This report was unanimous and was signed by Mr. Delano, as chairman,

[1] The controversy centered around the italicized portion of the section, and this has been copied verbatim from the Aldrich Bill (see Juxtaposition, pp. 202–203). The italics are mine—*Author.*

Mr. Harding, and myself. In view of the purposes which have been ascribed to this Committee, the report is of interest, because it shows beyond question what was in the minds of the Committee members. The report reads as follows:

December 2nd, 1915

To the Federal Reserve Board.

Your Committee on Redistricting has received and noted the copy of the opinion of the Attorney General addressed to The President of the United States, under date of November 22nd, 1915, to the effect that the Federal Reserve Board has not the power to abolish any one or more of the Federal reserve districts, or any one or more of the Federal reserve banks located in the cities designated by the Reserve Bank Organization Committee.

Your Committee feels that there has been a serious misunderstanding, not only of the substance and purpose of its preliminary report filed with the Board on November 13th, 1915, but also of the motives which prompted it. Therefore, before making any further recommendations, your Committee is desirous of recounting briefly the facts which led to its action and on which it based its recommendations, with the hope that a better understanding of the facts as they appeared to your Committee may promote a common point of view and conduce to a continuation of the harmonious coöperation and mutual good will that has in the past characterized the work of the Board and stamped it with the approval of the public at large.

On March 1st, 1915, Mr. Elliott [1] filed with the Board an opinion dealing with the general powers of the Board to review the determination of the Organization Committee, to readjust the Federal reserve districts, to change the designation of the Federal reserve cities, and to reduce the number of districts formed by the Organization Committee. It is to be noted, however, that, in this opinion, the question of reduction was referred to very briefly, and Mr. Elliott

[1] General Counsel of the Federal Reserve Board—*Author.*

later advised the Board that the consideration of this particular question was merely incidental to the main questions discussed in that opinion and that, should the question of reduction be specifically considered by the Board, he would appreciate an opportunity of reconsidering his earlier opinion on that particular point.

In view of the doubts raised by Mr. Elliott, members of the Board availed themselves of the opportunity of Senator Owen's appearance before it in the hearing of the appeal of certain Oklahoma banks requesting a transfer from the Dallas to the Kansas City District, to ask for his views concerning the intent of Congress and the meaning of the Federal Reserve Act relating to the powers of the Board on this whole subject. The request for Senator Owen's views was not accidental, but intentionally contemplated to instruct and guide the Board in disposing of pending appeals. His answer was that Congress meant to "give to the Board the power of the government itself in dealing with this system" and that he thought the power of the Board "would extend even to the power of reducing the number of the districts."

It is understood, of course, that this statement by Senator Owen was merely his own personal opinion and that it was made at a time when another, though closely related, subject was under consideration, but it at least indicates that there was no decided impression in Senator Owen's mind that this power to reduce was not given to the Board.

The Board subsequently published in the June 1st, 1915, Bulletin a resolution, which was passed unanimously on May 4th, 1915, when both Governor Hamlin and Mr. Williams were present, providing, among other things, as follows:

"That action on other pending petitions be deferred until further experience in the actual operation of the several districts, especially in the light of the new clearing system which is about to go into effect and of the extent to which state banks take membership in the Federal Reserve System, shall have provided the Board with the necessary data for a conclusion, it being the opinion of the Board that action on petitions relating to changes in cities designated as the location

of Federal reserve banks should be deferred until the Board shall have reached a conclusion from experience as to any further readjustments in the boundaries of the several districts, *or in the number of districts, which may be desirable in the operation and development of the Federal Reserve System.*"[1]

Your Committee is positive that no objection was raised at that time by any member of the Board or by any member of Congress, indicating dissent from the proposition that the Board had the right to reduce the number of districts. Indeed, such an argument was never raised in the briefs of counsel on the various appeals heard by the Board.

On October 19th, 1915, the following vote was passed, "to refer the question of *redistricting*[1] to a special Committee consisting of Mr. Delano, Mr. Harding and Mr. Warburg." Counsel for the Board were soon thereafter requested to prepare opinions as to the legal right of the Board to reduce the number of districts. Mr. Cotton filed his formal opinion on November 22nd, 1915, stating unqualifiedly that the Federal Reserve Board is fully authorized by the Act to reduce the number of districts. Mr. Elliott, who, in accordance with his own request, was reconsidering his earlier opinion of March 1st, 1915, filed his opinion with the governor on November 23rd, 1915, and on November 22nd, 1915, the Attorney General delivered his opinion addressed to the President.

It may be noted, therefore, that at the time of making its preliminary report on November 13th, 1915, your Committee did not believe either that members of Congress would take the position that the Board was without power to reduce the number of districts or that members of the Board would, in view of the unanimous resolution above quoted, take that view unless forced to adopt it by the conclusive opinion of counsel.

Your Committee began its work by elaborating a report submitting definite alternative plans, but finally concluded that it would be preferable to ask the Board first to pass upon the question of policy and the principle involved. Your

[1] The italics are the Committee's.

Committee had, however, reached a conviction that the country would be better served by a reduction in the number of districts to eight or nine. The reasons on which this conviction was based seemed so convincing and conclusive to the Committee that it hoped the Board might adopt unanimously the recommendation which it outlined. The Committee is desirous of emphasizing in the strongest terms its absolute confidence, not only in the underlying principles of the Federal Reserve Act, but also in the machinery provided for developing such principles into a system which has already brought immeasurable benefits to this country, and which, whether with twelve banks or eight, will prove of inestimable value. That the number of banks and districts originally created was larger than is conducive, in the opinion of your Committee, to the most efficient operation of the System and to the greatest safety of the country is not the fault of the Act, but is due to the fact that the Organization Committee, which, though acting in the best of faith, could not, in the short time allotted to it, acquire such knowledge and experience as is absolutely necessary to a final determination of such an important question.

The Attorney General has since denied the right of the Board to reduce the number of districts determined by the Organization Committee, and in view of that your Committee is not desirous of making any further recommendations at this time. It wishes, however, to emphasize the fact that at the time of filing its preliminary report, no doubt existed in its mind as to the wisdom of reducing the number of districts in the near future, but also the right of the Board to make such a reduction.

Your Committee is ready to submit an abstract of the arguments that were prepared by it when it supposed that the subject was to be discussed on its merits, and it is of the opinion still that these arguments will assert themselves sooner or later, and that the country will not rest satisfied until the Federal Reserve System shall have been developed to render its maximum possible efficiency. Furthermore, your Committee feels that, if the adjustment is not made at this time,

it is more than likely to be made at some future time, but with far greater difficulty and disturbance.

In reviewing the evidence before the Organization Committee it was noted that, of the *eighty-four* witnesses, only *nine* recommended the formation of twelve districts; a large majority favoring not to exceed nine districts.

Your Committee concluded, as a result of its study of the question, that the greatest protection from future disturbance was the immediate establishment of a system enjoying its maximum degree of usefulness and service. The country would not permit any subsequent interference with a machinery once perfected, whereas weaknesses, such as those which seemed to your Committee to exist now, offer a constant target for critics. For these reasons, not to mention the many practical advantages incident to carrying out, prior to January 1st, 1916, any changes that might have been decided upon by the Board, your Committee was sincerely anxious to secure prompt discussion and full consideration of its recommendations.

As the chairman of the Committee repeatedly stated, the desire for immediate consideration of the question was not prompted by any intention on the part of your Committee to force the Board to take any unconsidered action, and the fact that the request of two members of the Board for another preliminary report in writing as to the reasons for its recommendations was opposed by the Committee was, as explained by the Committee, solely because it desired to have the report discussed on its merits without delay and at that time lay before the Board all the facts and figures it had collected. Such a course was in consonance with our usual practice.

The Committee had postponed filing its report on account of Secretary McAdoo's absence in the West, and later waited until Mr. Harding had called on him at his house to apprise him informally of the views of the Committee and secure any suggestions which he might see fit to make. The Secretary, however, was unable, because of his own illness, and later by illness in his family, to discuss the matter with Mr. Harding, and the Committee then filed its report on Saturday,

November 13th, 1915, fixing the following Monday for discussion by the full Board, the Secretary of the Treasury having stated to members that he would be engaged on his report to Congress until the 15th, which the Committee assumed would leave him free after that date. However, consideration of the report was postponed until Monday, November 22nd, 1915, because of the inability of the Secretary of the Treasury to be present until that date.

At the meeting of November 22nd, the opinion of the Attorney General, already referred to, was presented; also, the letters of two United States senators. Your Committee desires to repeat that at no time had there been a discussion of the Committee's original report of November 13th, or of the revised report of November 17th. *The Committee therefore regrets that*, before it had the opportunity which it desired to make an oral presentation of facts and arguments, and various data in its possession the *Attorney General's opinion was sought without its knowledge.*[1]

Your Committee believes that it would have been fairer to the President, to the Attorney General, and to the Federal Reserve System, if the case had been submitted to the Attorney General with a full presentation of arguments on both sides of the question. If the Attorney General, for example, had understood that no closing of banking offices was contemplated but that in every city where a reserve bank was abandoned a branch bank would be established, he would not have been led to believe that the Committee's recommendation "would profoundly affect the currents of trade and alter the whole face of business throughout vast sections of the country," etc.

If your Committee was right in its conclusions as to the advisability of a smaller number of districts, the permanency which the Attorney General and every one of us desires for the future of the system would have been best secured by prompt and courageous action now.

Your Committee, however, fully appreciates the authority of the Attorney General's opinion and, submitting to the

[1] The italics are mine—*Author.*

conclusions reached therein recommends that the Board abandon, at least for the present, any plan of redistricting which involves the consolidation of any districts and that the Board now address itself to the specific appeals pending and to such readjustments as may be permissible and practicable under the Attorney General's opinion. . . .

How different this report of the Committee, presented at the time, sounds from the extraordinary account of the proceeding given by Senator Glass. He says:[1]

> There is one episode related to administration which occurred so soon after the system was set up and which was so intimately concerned with the very integrity of original federal reserve legislation itself as to make a reference to it here seem altogether pertinent. The pertinacity of those who held to the consolidationist view of bank credits has already been made clear. As we have seen, they ardently desired a central bank; and, denied that, exhausted every resource of ingenuity to prevail with Congress to make the number of regional banks as few as three, to be located in the three great central reserve cities.
>
> When, after months of consideration and discussion, this was not done, it was supposed the fight was ended. But it was not. The zeal of those advocating centralization was unabated and their persistence unchecked by repeated reverses. They carried the fight into the administration of the system; and, in less than one year after the federal reserve banks were organized for business, *the Federal Reserve Board at Washington entered upon a startling task of abolition which might have contravened the purpose of Congress by reducing the number of regional banks to any point at which the Board might have pleased to desist!* This extraordinary action was proposed and entered upon under an interpretation of the statute which, if valid, could have completely subverted the intent of the framers of the law. Indeed, the action proposed marked a critical moment in the history of the federal reserve banking

[1] Glass, *op. cit.*, pp. 255 ff.

system, for it not only involved an inevitable clash between Congress and the Board, with its attendant bitterness, but also would have precipitated a violent agitation in the districts sought to be abolished as well as in *other districts* which *might proceed in constant dread of a similar fate whenever it should suit the notion of the Federal Reserve Board to put them out of business. . . .*

The crucial point was as to the legal right of the Board to disestablish a single one of the twelve banks. Granted authority, under the statute, to revoke the charter of one, *the right to consolidate the system into three central reserve city banks, so desperately, but vainly, fought for in Congress, would have been confirmed. Disestablishment might not have proceeded that far; but it is by no means improbable that it would have gone to exactly that extreme without prompt executive intervention.*[1]

It should be recalled that Senator Glass is here referring to the convictions of at least four out of the five appointive members of the Reserve Board, convictions resulting from exhaustive study and earnest deliberations. To allude to such views as the result of the machinations of the "advanced consolidationists, intent on abolition of regional banks for the mere sake of centralization" is a manifestation of insincerity or of morbid obsession. The proposed action was not intended to destroy the System, as Senator Glass intimates; but was, on the contrary, designed to make it the most efficient organization possible under the provisions of the law. The law clearly provided that there should be not less than eight nor more than twelve Federal reserve banks. The Organization Committee had latitude to organize a system within these limits. The Reserve Board's power of review could not conceivably go beyond these same limits.

To claim that the abolition of one bank would confirm the Board's right to consolidate the System into three or less reserve banks is preposterous. That the Senator should

[1] Italics are mine—*Author.*

indulge in such fantasies, which, if justified, would constitute a grave indictment of his own draftsmanship of the bill, is scarcely believable. Yet, unfortunately, he is not alone, for this very thought was expressed in the Attorney General's opinion, to whom, "by request," Senator Glass had submitted a copy of his letter to Mr. Delano. The Attorney General says:

> The power of readjusting districts, and of creating new districts, conferred by this provision upon the Federal Reserve Board, is subject to two limitations only:
>
> First, there must be due regard to the convenience and customary course of business, and
>
> Second, the number of districts cannot exceed twelve.
>
> If, therefore, the power to readjust districts includes the power to abolish districts, I see nothing to prevent the Board from abolishing districts and banks until the number is reduced not only to eight, but to six, four or even one if in the judgment of the Board due regard to the convenience and customary course of business dictates that policy.

One is almost ashamed to draw attention to the fact that the Attorney General omitted to state that in this matter of districts the Federal Reserve Act also provides a minimum number of eight, which limit governed the Organization Committee and thereby also the Federal Reserve Board's power of review!

Dr. Willis joins the chorus when he credits Secretary McAdoo with similar thoughts. He says:[1]

> In addition, he undoubtedly felt the seriousness of the step which was proposed and recognized that if the number of banks could be reduced in the way suggested, there would be nothing to prevent its eventual further reduction and perhaps the final consolidation of all the banks into one, thus attaining the original purpose of the Aldrich Bill and of other proposed measures.

[1] Willis, *op. cit.*, p. 733.

I feel certain that the thought that the number of reserve banks could be reduced to less than eight never entered the mind of any one of the four members of the Board.[1] Had they ever given any indication of disregard for this clear and unmistakable meaning of the Act, then, indeed, there would have been full justification and ample opportunity for enjoining them, or "for prompt executive intervention," or for the "reorganization of the Board" to which Senator Glass alludes. But what a sad revelation this incident is of the humiliations to which men in high official positions are subjected! Although four men, who had accepted appointments at considerable sacrifice in order to serve their country, had carefully studied the problem, they were not given an opportunity to state their views. Instead, the President and the Attorney General formed their judgment solely upon the evidence of the Secretary of the Treasury, whose action was to be reviewed and who had studiously avoided hearing the views of the Committee, and upon the evidence of a governor devoted to Mr. McAdoo and acting in accordance with his instructions.

When Senator Glass says: "The Board was arrayed in two factions, the division being four to three, one side assuming to be trustees for the banks and viewing the other as representing the government,"[2] he does not, to my mind, express the situation correctly. The four of us considered ourselves the non-partisan trustees of the interests of the country at large; the other three dealt with the question from the point of view

[1] If any confirmation were necessary, a quotation from the Committee's revised report of November 17th, 1915, would furnish it:

"The ultimate judgment on this important question was to be that of the Federal Reserve Board, and Congress did nothing to impede the free exercise of the Board's judgment on this question other than laying down the requirements that the districts should not be more than twelve in number nor less than eight, and by prescribing that due regard should be given to the 'convenience and customary course of business'."

The Committee's revised report is printed in full as Appendix Twenty-Nine. It is a highly illuminating document.

[2] Glass, *op. cit.*, p. 270.

of the interests of their party. No stronger demonstration could be given of a partisan view than Senator Glass's own version and interpretation of this episode.

Even more astounding than Senator Glass's narrative, however, is that of Dr. Willis, who gives us the following account:[1]

> Unfortunately, Mr. McAdoo's interest in the situation had become seriously aroused only after the propaganda for reconstruction of the system had attained a very advanced stage, but upon looking into the conditions in the Board it seemed likely that he could not definitely be sure of more than two votes in addition to his own, the reconstructionists apparently having definite control of three votes with one doubtful, and likely to go their way on most issues. The case, therefore, was one which called for some finesse, since it obviously could not be met by direct ballot. *Without waiting longer for the hostile element to perfect its plans, the Secretary in his capacity as Chairman called for a meeting* at which the subject of reconstruction should be taken under advisement, and *at this meeting strongly urged upon the Board the view that the action proposed involved serious legal questions, the answer to which ought not to be assumed or taken for granted, but on which an opinion of the highest legal authority should be obtained.*
>
> Although various hesitant opinions of the Board's counsel had been rendered as to different phases of the reconstruction question, *Mr. McAdoo urged that the whole subject be transferred to the Department of Justice, there to be passed upon by the Attorney General of the United States, both as to the question of the Board's power to reduce the number of districts and also as to its power to change the location of the reserve bank cities. It was with the greatest difficulty that the Board was induced to consent to this reference, but eventually the meeting ended in a close ballot which necessitated a call upon the Attorney General for his opinion.*
>
> *The formulation of the letter transmitting the case then became*

[1] Willis, *op. cit.*, pp. 734–735. The italics are mine.—*Author.*

a matter of controversy in order that the language in which the reference was made might not contain any element of bias or suggestion. The terms of the letter having been ultimately agreed upon, it was sent to the Attorney General, and after the usual delay, due to elaborate consideration of the questions involved, an opinion was rendered on November 22nd.

The inaccuracies in the foregoing account are too glaring to require elaborate discussion. In passing, however, it may be noted:

1. The Secretary never "called" a meeting of the Board.
2. The Secretary never urged, strongly or otherwise, that the Board consider the legal aspects of the question.
3. The Board was never requested to submit, and never submitted, the case to the Department of Justice.
4. The matter of reference was never considered by the Board, and consequently there could not have been a close ballot.
5. For the same reason there could not have been a controversy over the formulation of the letter to the Attorney General.
6. Nor could there have been any controversy over the transmittal of such a letter from the Board.
7. The opinion of the Attorney General was rendered within about a week, which, far from being "after the usual delay," was an exceptionally short time for the delivery of such an opinion by the department.

It will be noted that Dr. Willis writes that the Attorney General's opinion was to be sought "both as to the question of the Board's power to reduce the number of districts and also as to its power to change the location of the reserve bank cities," and that an opinion was rendered on November 22nd, 1915. This is another misstatement. The Attorney General's opinion concerning the right of the Board to reduce the number of districts was asked for without the Board's approval and

delivered on November 22nd, 1915. The Attorney General's opinion concerning the right of the Board to change the location of the reserve bank cities was asked for by formal Board action several months later, and to this official request of the Board the Attorney General gave his reply under date of April 14th, 1916. In a footnote to his statement, Willis says: "The opinion of the Attorney General (*that is, the one of November 22nd*) is reprinted as Appendix "B." Looking up "Appendix B" on page 758 of Willis's book, the student finds an Attorney General's opinion addressed to the President, and beginning as follows:

"Sir:

At the request of the Federal Reserve Board you have submitted the following question for my opinion." [1]

But this is the opinion dated April 14th, 1916, to which, by a *legerdemain*, Dr. Willis added the opinion of November 22nd, 1915, omitting, however, the opening paragraphs of the latter. The beginning of the earlier opinion, addressed to the President, which he suppresses, reads as follows:

> SIR:
>
> I have your letter transmitting a request from the governor of the Federal Reserve Board for my opinion as to the power of the Board to abolish any of the existing Federal reserve districts or Federal reserve banks. The Secretary of the Treasury, who is the *ex officio* chairman of the Board, united with the governor in making this request, and you ask that I comply with it. . . .

Thus a composite version of two opinions rendered by the Attorney General upon two different occasions and upon two different sets of facts is made to fit in with Dr. Willis's story as told in the text above quoted. It is only by noticing the discrepancy in the dates that one would have reason to question the accuracy of the events recorded and to compare Dr.

[1] Italics are mine—*Author.*

Willis's reprint of the Attorney General's opinion with the originals published in the Federal Reserve Board's annual report for 1916 (p. 128) to which he refers. The two opinions of the Attorney General are reprinted as Appendices Thirty and Thirty-One.[1]

In dealing with this episode, Senator Glass, instead of attempting to correct Dr. Willis's story, follows along the same lines. He says:

> The action contemplated by the Board for Monday was deferred for one week *to get legal advice*[2] from the Attorney General of the United States, who was furnished, by request, with a copy of the foregoing letter.[3]

That Senator Glass's or Dr. Willis's memories should be at fault regarding the actual circumstances of the case, is all the more surprising because it had far-reaching consequences which surely they will remember. The four appointive members were deeply incensed at the action their colleague, Mr. Hamlin, had taken without their knowledge. Dr. Willis himself, as secretary of the Board, wrote the minutes of the meeting of the Board of November 22nd, 1915, at which both the Secretary of the Treasury and the Comptroller were present. In those minutes, a telling account is given of the very acrimonious debate that ensued and the earnest protests placed on record against the unauthorized request for the

[1] Dr. Willis's *The Federal Reserve System* abounds in statements which invite contradiction. It is, however, not my task to dissect this book of 1,800 pages, or to verify or identify the long list of documents, official and unofficial, signed and unsigned, dated and undated, abridged and unabridged, which it contains. In the above, I have analyzed a few pages of the book just where it became necessary to open it in connection with our discussion of Senator Glass's statements. This analysis will suffice to give those who might be tempted to consider Dr. Willis's work as authoritative an illustration of its methods and of the validity of its conclusions.

[2] The italics are mine—*Author.*

[3] Glass, *op. cit.*, p. 269.

Attorney General's opinion made by the Secretary of the Treasury and the governor.[1]

Senator Glass is likely to remember this occurrence because of the critical situation it engendered when Governor Hamlin's term expired on August 10th, 1916. The four appointive members personally had nothing but the friendliest feelings for Mr. Hamlin; but they had made up their minds that, if the prestige and independence of the Board were to be preserved, there would have to be at its head a governor whose friendship for, and loyalty to, the Secretary of the Treasury might not prove a menace to the independence and dignity of the Board. Two members of the Board, Mr. Delano and Mr. Harding, saw the President in order to impress upon him the desirability of adopting a system of a two years' rotation in the office of the governor; and, later on, on August 3rd, 1916, I had a talk with Mr. McAdoo in which I frankly explained to him that, while we respected and admired the feelings of friendship and loyalty that tied Mr. Williams and Mr. Hamlin to him, the independence and prestige of the Board made it imperative that one of the other four appointive members should be the next governor. At Mr. McAdoo's request, I furnished him on the same day with a memorandum in which I reiterated the arguments I had expressed in favor of the adoption of a system of regular rotation in the offices of governor and vice governor. Mr. Glass was fully advised of this determination on the part of the members of the Board to keep it independent. It was a struggle involving the future of the Reserve System, and in it, I believe, the four appointive members were not without his sympathy. This effort to prevent the Reserve System from becoming, in effect, a "Department of the Treasury" is described by Dr. Willis as a "cabal" to secure my appointment as governor.

[1] Temptation was great to ask the Board for permission to publish those minutes here; it was felt, however, that such publication would constitute a dangerous precedent which, in the interests of the Board, should be avoided.

Senator Glass, in Chapter XV of his *Adventure*, makes some very glowing remarks about the great independence enjoyed by the Board. As an illustration, he cites the case of a man whom a President wished to appoint to a prominent position in a reserve bank, and who was rejected by the Board. It is to be assumed that he refers to President Harding's unfortunate promise of the position of Federal reserve agent to a certain gentleman. Under the law, this office is filled, however, not by the President, but by the Reserve Board. Moreover, at the time, no vacancy existed. Senator Glass seems to overlook, or perhaps he never knew, that a member of the Reserve Board received a most sarcastic letter from the President about this incident; and that when in August 1922 the time came to reappoint the governor whose painful duty it had been not to follow the President's recommendation, the President did not reappoint him.

It is dangerous for the public to be inveigled into the belief that fearless members of the Reserve Board can rely on being protected. That the reverse, unfortunately, is the fact is shown by the case of the governor just cited. True enough, there was opposition to the governor's reappointment on the part of senators representing agricultural sections, whose unreasonable demands the governor had found himself in duty bound to oppose; and there was resentment on account of the sufferings of the deflation period, for which responsibility, if any, rested on the Treasury rather than on the Reserve Board. But the President did not make the fight for the governor which, for the sake of the prestige of the Reserve System, he should have made, and which he might have won.[1]

[1] As vice president of the Federal Reserve Board's Advisory Council, and as a member of a special committee appointed for that purpose, as well as individually, I saw President Harding several times and tried in vain to impress upon him the irreparable damage that might be done to the Reserve System if a governor of the Board, who had performed his duties faithfully and courageously and who had served the country at great personal sacrifice, were driven from office; if the Federal Reserve Act were amended so as to eliminate the

An account of the circumstances surrounding my own withdrawal from the Federal Reserve Board may serve further to illustrate how insecure is the position of members of the Board who in the exercise of their sworn duty find it necessary to antagonize persons of powerful political influence. For reasons easily understood I prefer to abstain from elaborating the case. Suffice it to state that it was not—as is generally assumed—my German birth that was the real cause of my withdrawal. While we were at war that phase of the question was only used as a blind by a senator opposed to my reappointment. The real cause of the Senator's ire lay in

clause under which at least two members were to be "experienced in banking or finance"; and if, instead, the Board's membership were increased from seven to eight with a proviso that the additional member should represent the farming interests. This was, however, exactly what occurred. A so-called "dirt farmer" was appointed as an additional Board member while in the place of Governor Harding, who was not reappointed, the President nominated and appointed as governor Mr. Crissinger, whom previously he had appointed Comptroller of the Currency. Mr. Crissinger was a lawyer by training; his banking experience had been gained largely through his connection with a banking institution in Marion, Ohio. He had had but little training in American commercial banking and none in international finance. There was no objection to the appointment of a farmer to membership on the Board. On the contrary, nothing could prove more efficacious in destroying misconceptions on the part of the agricultural classes concerning the functioning and the powers and duties of the System than the inclusion in the Board of a member of their own profession. It was a matter of deep concern, however, that, while on President Wilson's first list of five appointive members there had been two and at one time three bankers, there did not remain, under President Harding, a single banking expert among the appointive members of the Board. This was all the more deplorable because it came about at a juncture when America, now the gold pivot of the world, was called upon to play a leading rôle in the restoration of credit and exchange stability in all parts of the globe. In those years, pregnant with grave opportunities and grave responsibilities, the Board, like a parliament with too many factions, was incapable of exercising a strong and adequate leadership. If the Reserve System rose to its task in a manner that fills every American with pride, it was because the reserve banks themselves were capable of producing gifted personalities and standard bearers around whom they could rally. Happily, conditions have since been remedied by the appointment of Governor Roy A. Young, ex-Governor of the Federal Reserve Bank of Minneapolis, to succeed Mr. Crissinger, after the latter's resignation.

the fact that the Board had found it necessary to antagonize him in a fantastic scheme which, if enacted, would have seriously endangered the Federal Reserve System. It was for having opposed his plan and his "policies" that the Senator effectively blocked my reappointment by threatening to raise an issue which in the general interest I could not permit to become the subject of a bitter public debate.[1]

In his letter to Mr. Delano of November 13th, 1915, now reprinted in full in Chapter Sixteen of his *Adventure*, Senator Glass refers to a remark of mine to the effect that I would have been ashamed if, at a certain period, the reserve banks had earned their dividends. He also intimates that I stood in the way of permitting reserve banks to engage in certain open-market operations which might have enabled them to earn their dividends. These charges were hardly fair at the time, but a lack of understanding might have served as an excuse for them. Moreover, a few days after Mr. Glass had written this letter, he and I had a very long talk at my house, in which I protested against some of his statements and gave him full explanations concerning matters about which he seemed to be misinformed or which he had misunderstood.

It seems strange, therefore, that the Senator should have reprinted these charges at a time when the events of ten years of operation had fully vindicated the policies followed by the Board. It should be recalled that we were then in the period immediately following the opening of the reserve banks. The new reserve provision had brought about a very substantial release of reserve money and, in addition, there had been heavy imports of gold. The result was that an excessive state of ease in the money market generally prevailed. In such circumstances, it would have been a fatal, one might even say

[1] Mr. Glass was among those who tried to break down the Senator's opposition to my reappointment.

For my letter of resignation to the President of May 27th, 1918, and his reply of August 9th, 1918, see Appendix Thirty-Two and Appendix Thirty-Three respectively.

a criminal, mistake to make money still easier by forcing reserve funds into actual employment. To have done so would have stimulated inflation and frittered away our reserve power before the real strain, which some of us foresaw, had begun.

That this was my unmistakable meaning is plain if one does not confine oneself to the reading of a single and disconnected sentence quoted by Senator Glass from a speech delivered by me in Minneapolis, on October 22nd, 1915, at a dinner following a governors' conference. The speech in question may be found in Volume Two, page 307. It is not uninteresting, because it also contains some remarks denouncing the "pyramiding of reserves," which Senator Glass has charged me with having championed. My remarks were directed primarily at the governors themselves, because some of them had grown discouraged and confused, as a result of the fact that some members of the Board were pressing for earnings and the Comptroller was pointing with particular pride to the fact that in his home State the Federal Reserve Bank of Richmond was earning a dividend. It was in order to keep these men in line, and to prevent the System from embarking upon a policy of inflation, that my remarks were made.

In several public speeches made in 1915 and 1916, which may be found in Volume Two, I openly admonished the reserve banks not to permit themselves to be stampeded into a policy of inflation by surrendering to pressure from those who, for political reasons, wished to see the efficiency of the Reserve System demonstrated by premature declarations of dividends. My memorandum to the Board, reprinted as Appendix Thirty-Four, dealt fully with the problem.

It is hard to explain how, in these circumstances, Mr. Glass could write to Mr. Delano that, under my influence: "Federal reserve banks have not tried to earn expenses. Quite the contrary, they have tried not to earn expenses; to my knowledge *they have intrigued to this end.*" [1]

[1] Italics are mine—*Author.*

It seems humorous for Senator Glass to depict me as an opponent of open-market operations. Anyone familiar with the inside history of the Reserve System knows that, for many years, I was the outstanding champion of these operations, often in opposition to the majority of my colleagues on the Board; indeed, I continued to preach the gospel of open-market operations even after my membership on the Board had ceased. If any evidence to this effect is required, it is only necessary to refer to an address which I delivered at the annual meeting of the American Acceptance Council on January 19th, 1923. This address may be found in Volume Two, page 819.

Senator Glass says: "Under Mr. Warburg's persistent leadership the Board had failed to put into operation mandatory provisions of the Act which were intended to enable the Federal reserve banks to earn expenses." This charge may refer to my opposition to a plan of plunging the Reserve System into the buying, in the open market, of bills, to be purchased from corporations, firms, or individuals direct, unguaranteed by a banking endorsement or acceptance, and involving, therefore, a commercial risk and political dangers which I believed the System must avoid at all hazards. As to that, I have not changed my convictions and I am quite confident that every conservative business man and banker who has the future of the System at heart will agree with my point of view.[1]

[1] Fourteen years of actual operation have brought convincing proof that, Dr. Willis to the contrary notwithstanding, it is not necessary for the Reserve System to deal directly with the public in order to secure earnings, if that be the objective, or in order to establish itself as a dominant factor in the open market.

As to the charges made in Mr. Glass's letter of November 13th, 1915, it may be interesting to quote the following passages from his speech, already referred to, of September 7th, 1916. Answering the ridiculous assertions made by some members of the Republican side that the Federal Reserve System had cost the government more than one and a half million dollars, he said:

It is significant, however, that at the time charges of this character—*i. e.*, that I was blocking the reserve banks for the purpose of proving the failure of the Federal Reserve Plan in order to clear the way for a central bank, or that I was unwilling to permit the reserve banks to make investments, because I was anxious to shield the big banks—were carried not only into the halls of Congress, but also into the White House. A member of President Wilson's intimate circle, who had heard them discussed in the President's presence, asked me about them. After I had explained the actual facts to him, he urged me to seek an interview with the President

"Suppose it were true that all the banks are not earning dividends. Have gentlemen such a radical misconception of the real purpose of the Federal Reserve System as to imagine that its primary object was to earn dividends? That was not it at all. It was established to conserve the banking facilities of the United States; to constitute a great reserve force; to keep in poise the banking and currency interest of the nation. The only Republican member of the Federal Reserve Board, Mr. Paul M. Warburg, a banker of international fame, speaking to this point in Minneapolis not long ago, said:

'Earning capacity must never be considered the test of the efficiency of Federal reserve banks. Personally I should have felt heartily ashamed had all our banks, considering the circumstances under which they began operations, earned their dividends in the past year. Such an earning, with all it implied, would have been a proof that they had completely misunderstood their proper functions and obligations.'

(Applause on the Democratic side.)

"Would gentlemen who criticize the Federal Reserve System on this score have the reserve banks make a campaign for dividends when member banks, in consequence of the reduction of reserves by the Federal Reserve Act, are swollen with funds and credit? Would they have them do this merely to be able to say they had earned dividends? I will tell you why the reserve banks are not earning large dividends. It is because there are $2,076,000,000 of reserves in national banks, which is $801,000,000 more than the legal requirements."

(Applause on the Democratic side.)

It thus appears that while Mr. Glass at the time he wrote his letter to Mr. Delano did "not agree as to the economics" of my views, he did accept them ten months later. It is all the more incomprehensible that he should have seen fit to republish this letter with the charges and innuendos he had since learned, and publicly acknowledged, to have been unwarranted.

because, as he said, the President had been worried by the stories told about me. The President gave me the desired appointment (June, 1916); and though I sensed that his mind was gravely occupied with the momentous problems then before him, he gave me his full attention during an interview that must have extended over twenty minutes. His easy grasp of the problem made a lasting impression upon me. We had not proceeded very far before I felt satisfied that, whatever misconceptions might have existed, he now fully appreciated the motives that were prompting the majority of the Reserve Board in fashioning the policies of the Reserve System. He permitted me also to avail myself of the opportunity to present to him the views entertained by some of us concerning the desirability of simplifying the administrative problems of the Reserve System by a moderate reduction in the number of the reserve banks.

To this proposal, however, the President would not agree. Conceding that, from the point of view of efficiency, the System might profit if simplified as suggested, he believed it of greater importance that it should preserve a larger number of points of contact. Needless to say, I tried to show that the desired contacts could be secured with equal success by the establishment of branches. The President held, however, to the view that, in this regard, branches would not be so effective as independent reserve banks and, within the limited time that had been given me and which, under the existing conditions, was all that I had any right to claim, it was not possible to pursue the argument any further.

I left the White House, however, with the confident feeling that no doubt remained in the President's mind with regard to the sincerity of my motives and the honesty of my convictions. It was natural that the President, in this question, could not disregard the political considerations, while it was my duty to approach the problem from a non-partisan and non-political point of view, with the sole thought in mind of

what the best interests of the Reserve System, that is, the interests of the country, as a whole, required.

In view of Senator Glass's statement that the President asked him whether it was not time for him "to reorganize the Board," it is interesting to chronicle that when, finally, the President did "reorganize" it on August 10th, 1916, Mr. Harding was made the governor, and I became the vice governor of the Board. We had been plain members until then.

While the appointive members, fighting for the independence of the Board, were greatly cheered by the President's at least partial recognition of their views, they were much distressed to find that, in order to save appearances for the governor, the vice governor, Mr. Delano, had been sacrificed. When I expressed my unwillingness to take his place, Mr. Delano showed his rare character and superb devotion by completely disregarding his own position; he insisted that it was for the best interests of the System gracefully to accept the White House decision and not to incur the risk of irritating the President by any attempt to persuade him to change his selections. Mr. Delano and Mr. Hamlin went back to the ranks like true soldiers; they took their seats as plain members in a spirit of undiminished zest and unexcelled loyalty to the Board's work. Force of circumstances, creating a dual allegiance for some members of the Board, had placed them in a perplexing and unenviable position which inevitably had to lead to an open conflict if the Board's independence was to be preserved. It is a pleasure to state, however, that these differences of the initial years did not in the end affect the personal relations between members. They learned to respect their colleagues' opinions, even where they differed, and friendships were formed which grew warmer with every succeeding year and which have endured.[1]

[1] Mr. Delano withdrew from the Board in July, 1918, two years before the expiration of his term, in order to join the Army. He went to France and took a prominent part in the running of the sector of the French railway system which was turned over to the United States.

I wrote to the President on August 14th, 1916, accepting the appointment as vice governor and expressing my thanks for his confidence in me as shown by the designation.

At the same time, I expressed the hope that some day he might see his way clear to adopt the principle of automatic, instead of selective, rotation in dealing with the Board's governorship and vice-governorship. I added that I would deem it a great privilege if, at some time in the future, when the heavy burdens then resting on his shoulders were removed, I might be permitted to discuss this problem with him. The President answered very graciously that he would be glad to confer with me about the matter; but that, in the troublesome conditions then prevailing, this seemed to him, for the time being at least, a luxury which he would have to deny himself. It need hardly be explained that the opportunity for a further discussion of the subject never offered itself.

The war clouds threatening our sky grew darker and darker, and soon they broke. Problems that had seemed all-important now dwindled into insignificance. Differences were submerged and forgotten. We shook hands and turned with a united will to meet the great task that lay before us.

In this chapter it has been necessary to deal with ephemeral personal questions to a much larger extent than is agreeable to a writer who prefers to treat his subject from an impersonal and detached point of view. After Dr. Willis in 1923 and Senator Glass in 1926 had lifted, however, a corner of the veil from events concerning which, in the interests of the Federal Reserve System, the four members of the Board involved had remained silent for thirteen years, it became imperative to raise it further so that the real facts might be known and the story freed from the half-truths and perversions by which it had been clouded. Yet it should be stated that for the mere purpose of refuting false charges the unenviable task of relating and elaborating these incidents would not have been undertaken. The facts recited in this chapter have been presented

because they throw an instructive light upon the trying conditions in which Federal Reserve Board members serve their country. Without a fair knowledge of these conditions neither the grave dangers menacing the future of the Reserve System, nor the nature of the remedies to be sought, can be adequately understood.

CHAPTER XII

LOOKING FORWARD

The recommendations contained in this chapter were formulated in the spring of 1927, substantially in the form in which they are here presented. Since then the Federal Reserve System passed through two trying years, in which a wave of mad speculation in stocks engulfed the entire country, ending in the fateful collapse of brokers' loans and stock prices in the crash of October–November, 1929. When the catastrophe took place, this book had already reached the page-proof stage, and it was deemed impracticable, therefore, to attempt to recast it, and particularly this chapter, so as to take account of recent occurrences. Moreover, the recommendations made in this chapter deal largely with structural problems of the Reserve System, and it appeared desirable not to permit them to become clouded by the consideration of questions of an essentially ephemeral character. It seemed profitable, however, to review our suggestions in the light of the experiences gained in these two years, and with this end in view, a postscriptum containing a brief discussion of this episode has been added. It will be found as Addendum II (Volume One, pages 501 to 517), following Addendum I, which deals with the Chicago rate controversy of the summer of 1927.

BOTH friends and enemies of the Federal Reserve System will agree that, speaking by and large, it has been functioning admirably and that, in some respects, it has surpassed all expectations. The surprising rapidity with which it attained a position of unequalled strength and a key position among all nations, the ease with which it handles its gigantic daily transactions, and the confident assurance of safety it gives the country, make it the marvel and envy of the

rest of the world. But when all this is said, the fact remains that the more precious our treasure, the more imperative it is for us to safeguard it against deterioration and decay.

It is from this point of view that it is all-important that we conscientiously inquire into the Reserve System's state of health, that we face frankly and treat boldly any menacing germs of disease that we may find, instead of ignoring them or denying their existence.

We may forego dealing with the smaller defects to which attention has been drawn; they are likely to find their own cure in due time. Some major aspects, however, in which the Reserve System has proved defective should be discussed at length.

Turning our attention first to the technical side of the problem, we must state as one of the System's most serious shortcomings its failure to create important discount markets outside of New York City and, as a corollary, its failure to lessen the congestion of the country's unemployed funds on the New York Stock Exchange.

The concentration of the country's money on the New York Stock Exchange is more pronounced to-day than ever before.

As has been repeatedly stated on earlier occasions, the excessive concentration of the country's fluid money in the New York market could have been decreased by the adoption of a term-settlement plan for at least some portion of New York's stock exchange transactions. If such a system had been developed, a substantial portion of the billions of dollars now employed on the stock exchange would have been invested in fortnightly loans, instead of being put out "on call;" and "call money" thus might have been encouraged to seek a more active employment in the discount markets. The present condition is fraught with grave dangers for the banks, as well as for the stock exchange itself. It is impossible to believe that a country excelling in business acumen will permanently submit to the hazards of a system that per-

petuates the wastes and risks involved in carrying a structure of many billions of dollars of loans callable and renewable from day to day. While the Reserve System is not directly connected with, nor responsible for, the operations of the stock exchange, it could not be unaffected by a tottering of this Colossus that keeps on growing from year to year. For if disaster should overcome the exchange, the banks would be involved, and the banks are the wards of the Reserve System. Moreover, stock-exchange operations absorb vast funds that should properly flow into the bill market which, as the most desirable meeting-ground for the lenders and borrowers of the country's daily surplus funds, was designed to form the very foundation of the Reserve System.

While, in view of the magnitude of the sums involved, a remodelling of our present methods would needs have to be undertaken with the greatest caution, and only very gradually, as experience drawn from actual operation would permit, it is highly desirable that carefully planned experiments in "term-settlement" trading should be undertaken at an early date with a limited group of securities.

The reserve banks, the commercial banks of the country, the stock exchange, and the people at large all have a very deep interest in the ultimate establishment of a properly safeguarded system of term settlements. An old sage said that "it is difficult to legislate for prosperous people." It is small wonder, therefore, that during these last years a majority of busy stock-exchange members should have been adverse to any far-reaching changes in their present customs. For those looking farther ahead, however, it remains a matter of profound regret and concern, that a general apathy or lack of leadership has permitted the problem to remain unsolved, while the loan structure continued to mount, increasing the magnitude of dangers and rendering it a more and more difficult task to change existing methods. The Reserve System cannot afford to stand still and permit the development of an

adequate discount market to wait for the initiation by stock-exchange authorities of needed corrective measures. Nor can the System wait for voluntary remedial action on the part of the banks, when experience has shown that, of their own free will, they will not employ their funds in the bill market as long as it is simpler, and at times more profitable, to invest them in stock-exchange loans.

The country must have a wide and freely used bill market if it is ever to enjoy as perfect a banking system as that to which it is plainly entitled. If fourteen years of practical operation under the Federal Reserve Act have not been able to evolve such a market as an outgrowth of the banks' voluntary action, for the reason that the hands of those willing to act in the public interest are tied by those who take a narrower and more selfish point of view, then, no matter how intensely one may abhor "banking by law," a recommendation would seem warranted to make it mandatory upon the banks to create a bill market. This could be done by providing that any member bank investing its funds—directly or through correspondents—in call loans on a stock exchange should set aside an amount equal to a given proportion of the funds so employed and invest the amount so withheld in eligible acceptances or loans thereon. In other words, against call loans on the stock exchange, banks would carry a secondary reserve in the bill market, a reserve, however, that would bear interest and could be averaged over the year.[1] Similarly, member banks making call loans on the stock exchange "for account of others" would be required to withhold a given proportion of the funds to be so loaned out, treating the amount so set aside as a

[1] Permission "to average" such a reserve over a year would enable the member banks in times of increased demand, seasonal or otherwise, to sell a portion of their bill holdings to the market or to the Federal reserve banks, and to make good a shortage in their required reserve so incurred by carrying a correspondingly larger amount of bills in periods when credit demand is usually low.

balance to be invested by them in eligible acceptances or loans thereon.[1] In order to avoid any embarrassment that might follow from the imposition of such a legal provision, the law might stipulate only the maximum percentage that might be required to be so invested, while the Reserve Board, in consultation with the reserve banks, might be given power to fix the minimum at its own discretion. Thus, by the Board's setting this minimum at a very modest percentage, a withdrawal of funds from the stock exchange could be carried through quite gradually without creating any commotion; and no greater amounts would be withdrawn than the bill market in practical operation would be capable of absorbing. Inasmuch as in many parts of the country purchases of acceptances and loans thereon could often be made in the districts where the banks with the funds to be lent or invested are located, it may be confidently assumed that some discount markets, larger or smaller, as the case might be, would then develop outside of New York. Money in larger volume might thus find employment in its home market, as the writers of the Federal Reserve Act had in mind.

If this plan were carried into effect and if the Federal reserve banks should continue normally to keep their buying rates for short bankers' acceptances substantially lower than their rates for the longer maturities, it would prove a profitable practice for member banks to buy long bankers' acceptances at the higher rate and sell them to the Federal reserve banks at the lower rate, as these bills approached maturity and as the member banks found it necessary to have recourse to the Federal Reserve System's credit facilities. A development along these lines would materially increase the daily contact of the Federal reserve banks with the member banks and the money market.

[1] This would involve the coöperation of the principal New York private banking firms whose self-interest as well as public spirit, it is to be hoped, would lead them to assist in carrying such a plan into effect.

Members of Congress who are exercised, and justly so, over the excessive accumulation of the country's fluid funds on the New York Stock Exchange, might well ask themselves how far they themselves are responsible for this condition. We are not referring here again to the unfortunate results of the Federal Reserve Act's effort to create too many independent reserve centers, but wish only to point out that for over a decade Congress has consistently sacrificed the bill market to Treasury requirements. It is generally admitted that while we were at war, and during the subsequent readjustment period, this subordination of commercial to fiscal needs was inevitable. But the point seems to have been reached long since when the requirements of agriculture, commerce, and business should exert the major influence in determining the direction of the flow and the price of the country's money. Banking funds that went into bills have, however, been subjected to the burden of the income tax, while bank money going into short-term or long-term obligations of the United States Government has been freed from that tax. As a consequence, government securities have preëmpted the place which in the portfolios of the banks the commercial bill should occupy, and instead of seeking to acquire large holdings of bills eligible for rediscount with, or for sale to, the reserve banks, member banks have come to rely primarily on their ability to use for that purpose their own notes secured by government securities.

Against expert advice Congress, several years ago, went to the extreme of inserting a provision requiring foreign holders of American bankers' acceptances to file an income tax return for the income received from such bills. As was to be foreseen, the United States Treasury has never been able, nor has it ventured, so far as is known, to collect tangible sums under this heading. But the unfortunate effect of the law has been to prevent hundreds of millions of dollars of foreign money from flowing into our bill market. In the spring session of

1928, Congress amended the Revenue Act (Sec. 119) so as to exempt at least the foreign central banks from this tax. It is difficult to understand why the amendment was not drawn so as to include *all* foreign holders. The government would not have lost anything by giving up what it does not and cannot collect, and if, instead of being deterred from doing so, foreign banks had been encouraged to buy our dollar acceptances liberally, our producers and consumers would have benefited thereby. It is they who profit from lower open-market rates for acceptances drawn to finance the shipment and exportation of cotton, grains, oil, coffee, or manufactured articles, or for the importation of coffee, tea, sugar, or rubber. Producers and consumers would derive a still greater advantage, and our entire banking structure would be greatly strengthened, if acceptances, held not only by foreign but also by American banks and corporations, were placed on an equal basis of tax exemption with government securities.

If we contemplate the far-reaching effect that the granting of the tax exemption here proposed would have in placing our banking system on a sound basis, the amount that the Treasury might thereby lose in tax receipts seems trivial. Figuring an average interest rate on acceptances of 4 per cent and assuming an average volume of acceptances outstanding of one and a half billion dollars, the total tax involved would amount to approximately six and a half million dollars per annum, provided that all acceptances were held by American banks and corporations. At present, as is well known, about one-half of the aggregate is held, however, by Federal reserve banks and foreign central banks, neither of which pay the income tax involved. It is safe to estimate, therefore, that the risk of loss involved for the Treasury from the adoption of this plan would at present not exceed three to four million dollars a year.[1]

[1] If it had not been for the emergency created by the War, it is safe to assume that, as in the beginning, borrowings against government securities

The point has been raised that the supply of American bills might not be large enough to furnish an adequate basis for a wide call-money market. But we must remember that, even in the very remote eventuality that a large majority of all speculative stocks were placed on the term-settlement list, there would always remain, as in Europe, a very important "on call" market for money secured by non-speculative investments for which cash dealings would continue. The bulk of the money now employed on the stock exchange, or as much as it should reasonably require, should, as we envisage it, remain there in the form of bi-weekly and call loans as the second line of secondary reserves. The bill market would be the main medium for the investment of bank funds serving as the first line of secondary reserves. From these funds the debit and credit balances arising between banks would be adjusted from day to day, and between settlement days free bank funds would flow primarily into this reservoir instead of into the stock market. On settlement days increased demands of the stock exchange would cause heavier drafts on the bill

would still be subjected by the reserve banks to a rediscount rate one-half per cent higher than the corresponding rediscount rate for commercial paper (according to the practice of many European central banks). The time seems to be near at hand when this practice might be readopted by our reserve banks. It might lead our bigger institutions to hold larger portfolios of eligible bills and to prefer to meet extraordinary demands by disposing of their bill holdings at the lower rate rather than to borrow at the higher one.

Some writers have made the ill-advised suggestion that member banks' notes secured by stock-exchange collateral should be made eligible for rediscount by Federal reserve banks and they have cited, in support of their recommendation, the practice of some European central banks in granting so-called "Lombard loans." It may be well to remind these writers that the aggregate of such "Lombard loans," in some cases restricted to the collateral of government bonds of the respective country, would range within about $50,000,000 each for the Reichsbank, the Nederlands Bank, the National Bank of Belgium, the Swedish Riksbank, and some $100,000,000 in the case of the Bank of France. Bills secured by United States Government securities rediscounted with Federal reserve banks frequently aggregate in excess of $600,000,000.

One shudders to think what would happen to the Federal Reserve System if its doors were opened for the carrying of stock-exchange collateral.

market while, conversely, decreased demands would tend to increase the drift of money into the bill market, particularly so if the tax exemption above recommended were granted. For these purposes our present volume of acceptances of over one and a half billion dollars would offer a very substantial basis; but it may safely be assumed that an increased demand for bills, as it would follow from the adoption of the proposals here outlined, would fairly quickly further enlarge their volume.

The part played by the reserve banks in the development of the American bill market has been admirable. They have always stood ready to buy sound eligible American bankers' acceptances and have given to these bills an unexcelled standing in the world markets, so that to-day, outside of our own reserve banks, foreign central banks are the largest buyers of dollar acceptances. As an international instrument of exchange the dollar acceptance has fully vindicated itself; it has gained the very position for itself that some of us foresaw and hoped for over twenty years ago.

As far as our foreign relations are concerned, a very satisfactory open market has thus developed, with the Federal reserve banks on the one side and the foreign investors on the other, a market in which foreign central banks buy acceptances or, according to their own needs, collect them at or before maturity.

With us, on the other hand, the bankers' acceptance does not occupy a similar position as the principal connecting link between the Reserve System and the commercial banks. It is easy to see why this is most unfortunate. Domestic open-market operations, in the final analysis, mean a release of reserve funds to the market, or a withdrawal of reserve funds from the market, through a voluntary increase or decrease of the investment load carried by the Reserve System. These transactions are of vital importance; they are indispensable for the proper functioning of the Reserve System and for the proper protection of the country. It is a pre-

requisite for such transactions, however, that the market generally own in liberal quantities, and be, therefore, able to sell, the type of investments the reserve banks are permitted to buy and, conversely, that the market be ready at all times to purchase freely the assets the reserve banks may wish to sell. Bankers' and trade acceptances—"discounts," as Europe calls them,—constitute the most desirable *means of exchange* between central banks and the market. Since our banks buy or sell "discounts" for their own account only in an entirely inadequate volume, while they are liberal investors and traders in government securities, it is clear why under present conditions government securities play so important a part in the transactions between the Federal Reserve System and the banks and why, by the same token, the open-market rate for bankers' acceptances has not been able to gain an adequate influence over the money market.

This is not the place to elaborate the thesis that a country is better served by a system built upon the bill market with its facilities to direct unemployed funds into the marts of commerce and trade, than by one which steers these funds most largely into the stock exchange. (Several of the articles reprinted in Volume Two deal with this topic at length.) Suffice it to say here that under our present system the most natural contact between the Reserve System and the market and the healthiest basis for the System's operations is lost.[1]

[1] For a decade after the conclusion of the War we lived in an era in which gold had lost its position as the dictator of the policies of central banks. In the Old World most countries had cut the hawser that tied them to the yellow metal, because they had lost the power to command or to hold it, while we, in the United States, had accumulated so much more gold than we required that it had ceased to exercise any restraining or regulative influence. With the gold compass gone, the world began to look about for another instrument of direction, and "price levels" became the new star by which to guide the policies of central banks. Leaders among European economists, as a consequence, became converts to the gospel of "managed currencies," while here, where by a combination of fortunate circumstances it had been possible to keep the index of prices fairly level, extremists went so far as to seriously recommend an

The need of the reserve banks to buy or sell substantial amounts of government securities for the sake of strengthening or loosening the System's control over the money market, and

amendment to the Federal Reserve Act which would make it mandatory for the reserve banks to fashion their discount and open-market policies according to the requirements of price stability. (For resolution of the Merchants' Association of May 24th, 1927, opposing such amendment, see Appendix Thirty-Five).

We are now entering another era of gold psychology. In one form or another, leading countries in the Old World have once more adopted the gold standard, and once more the tug of war for gold is taking place between central banks just as during the period before the Great War. It will be a fortunate development for the United States to be forced again to give more heed to the effect of gold movements on our own reserve position. For the Reserve System will be less subject to the charge of carrying on arbitrary policies and less exposed to the demands and schemes of dreamers, theorists, and demagogues, when once more it is clearly recognized all over the world that the first duty of a central bank is to preserve its country's gold standard, and that discount policies must first, and almost automatically, be directed towards that purpose, with stability of price levels and kindred aims as ends to be achieved only incidentally, in so far as the attainment of the first aim permits.

Because the Federal Reserve Act stipulates minimum gold reserves of 40 per cent and 35 per cent against Federal reserve note issues and deposits respectively, the man in the street is inclined to consider any reserves in excess of these percentages as signs of strength. He overlooks, however, the fact that these percentages indicate not the norm, but the danger marks, and that reserves must find their normal levels far above the minima stipulated by the Act. Moreover, in writing these percentages into the law (against the determined opposition of those objecting to any specified reserve percentages on the ground that it would tend to "make the people's money dearer to the masses") European pre-war standards were generally followed. We must be mindful, however, of the fact that in those days gold was carried in the pockets of the people. The ten-shilling and pound sterling gold coins, the ten- and twenty-franc pieces, or the ten- and twenty-mark pieces, etc. in actual circulation formed secondary gold reserves of vast importance for central banks to fall back upon. To-day practically all the gold has been massed in the central banks. The secondary reserves of circulating gold currencies no longer exist in the Old World, while at the same time the financial structures resting on the central banks' gold holdings have greatly increased in weight and size. Hence orthodox pre-war theory concerning gold reserves ought to be revised and it should be realized that under present conditions for countries able to do so, it would be safer to place the minima on a substantially higher level. Furthermore, many central banks are treating to-day their balances in England and in the United States,

the obnoxious incentive to invest in these securities for the sake of obtaining larger earnings, could be greatly lessened if, at the proper time, the Federal Reserve Act could be amended so as to permit the reserve banks to establish an immediate credit check collection system, subject to an interest charge covering the check's trip to its place of payment (without charging for the time to be allowed for the return trip of the funds to be remitted), the interest to be charged at a rate to be published from time to time. In earlier chapters, we have already dwelt upon the anomaly of the present "deferred credit" system which, in spite of its excellent service, constitutes another serious defect of the Reserve System.

If the reserve banks operated a "deferred credit" as well as an "immediate credit" check collection system, the official rate of interest which would be charged for collections from time to time would prove to be a very instructive gauge of the money market, and an additional means of controlling it. If the rate were too high, banks generally would be led to use the deferred credit system; if it were too low, a moderate increase in the rate would at once be felt all over the country. The danger that the free use of an immediate credit system might weaken the strength of the Reserve System and cause inflation could be safeguarded against by permitting the Board in its discretion to increase correspondingly the member banks' "required reserves" against time deposits. There is no reason, however, to doubt that the reserve banks' aggregate

and their portfolios of prime bankers' bills payable in these countries, as part of their gold reserve. These balances and bills may be converted into earmarked gold at any time, or gold may be actually demanded against them for shipment. It is estimated that in excess of a billion and a half dollars of foreign reserve money is thus invested in the United States. While we have means to counteract or offset an embarrassing demand for gold made upon us from abroad, yet it behooves us to remain conscious of the fact that to a very large extent we are to-day a reserve bank for the entire world and that a psychological minimum of 60 per cent for our gold reserves would be more in keeping with present circumstances than the 35 per cent or 40 per cent stipulated by the Act.

investments in checks for collection could be held within safe bounds by an intelligent use of the rate of interest to be charged, and by the adoption of regulations imposing certain limitations for the protection of the reserve banks against abuse. The system as here proposed would establish a more constant, a more direct and intimate contact with the banks of the country, and the control to be exercised by the reserve banks would, as a consequence, become a steadier and more effective one than it is at present.[1]

But it is not only through their actual investment activities—no matter whether they result from rediscounts, collections, or open-market transactions—that well-organized and capably administered central banks exercise their sway. The indirect influence of their operations is of equal importance. In many countries of Europe the effect of a change in a central bank's discount rate is very materially increased by the practice of the leading commercial banks of keeping the rates of interest they allow and charge in a fixed relationship to the central bank's official discount rate. As a consequence, a lowering or raising of that rate immediately affects not only the borrowing banks but the rate structure of the entire country. The psychological effect of a central bank's change of policy is thus greatly enhanced. It is obvious that the stronger this psychological effect the more moderate the increase or decrease of the official rate normally need be. Conversely, if a central bank's discount rate, for one reason or another,

[1] In order not to divert attention from the main proposals offered in this chapter we refrain from dealing with another major defect of the Federal Reserve System, viz. its failure to absorb the inelastic national bank circulation. Our own thoughts and suggestions were expressed in the article "The Owen-Glass Bill" (see quotations on page 109, Chapter VI of this book, and the argument in full in Volume Two, pp. 260–264 and pp. 295–300); suffice it to say here that if the Federal Reserve Act had provided for a bolder plan for the immediate conversion of the national bank notes into Federal Reserve circulation, the question of earnings of reserve banks would have been solved from the beginning and the strategic position of the reserve banks would have been greatly strengthened.

exercises only an unimportant influence, it must be advanced or lowered much more drastically in order to make itself felt if, indeed, in such circumstances it can adequately assert itself at all.

It is to be regretted that after having adopted the commendable practice of tieing their rate structure to their Federal reserve bank's discount rate,[1] our commercial banks should have decided once more to abandon this method and that, apparently, they were encouraged to do so by the Federal reserve banks themselves. This unfortunate development can be explained only by the assumption that the Federal reserve banks themselves had become apprehensive lest a closer interrelation of commercial and official bank rates, which would tend to intensify the effect of a change in the official rates, might render it still more difficult to secure a prompt agreement and fearless action on the part of the many persons involved in passing upon the question of rate changes. The commercial banks, on the other hand, we may assume, were reluctant to bind their own rate structure to the fluctuation of a discount rate which, for political reasons, or from ignorance, or inability to agree upon any action—conceivably at least—might be established upon a level not in keeping with actually existing economic and financial conditions.[2]

If the apprehensions here outlined were the guiding motives of the Federal reserve and commercial banks respectively, then these fears, unfortunately, were well founded. It cannot be denied that, as the System is organized and as its management is constituted to-day, it would hardly be safe to clothe it with additional powers or burden its actions with wider responsibilities.

[1] Arrangements of this type are commonly made by a resolution passed by the Clearing House binding its members to allow interest on deposits at a rate of 2 to 2½ per cent below the "bank" rate and to charge interest for overdrafts at a rate of 1 to 1½ per cent above the "bank" rate.

[2] The Federal Reserve System's record of the first semester of 1929 has since convincingly illustrated the point.

Hence, an exasperating dilemma seems to face those ambitious to secure for the United States the highly perfected banking system to which, as the largest financial power, the country is clearly entitled. For our own safety, and that of the whole world, it is imperative that in our Federal Reserve System we should command an organization of the highest efficiency and power—yet it cannot be denied that the difficulties of properly managing such an organization are immense and that the more powerful it be, the graver the consequences of mistakes made in its use.

There is no central bank in the world, however, the management of which is blunder-proof. But would occasional errors lead any country of financial importance to wish to forego the benefits derived every day in the year from the operations of its central bank, or cause it wittingly to weaken the central system's invaluable powers of protection? If there should be overwhelming evidence of blunders committed in its operation, should not the remedy be sought in improving the management rather than in crippling the System?

It is probably true that, on the whole, our own central banking problem is more difficult than that of any other nation in the world. The vast expanse of our country; the immensity and diversity of its resources and interests; the complexities of our political life and of a decentralized system of thousands of individual banks; the existence of stock exchanges and industries of overtowering strength, standing outside the System's immediate control and brooking no interference, all these combine to complicate the difficult task of developing and administering the Federal Reserve System in a manner that would enable it to render the fullest measure of service of which, within the limits of its proper functions, it is capable.

That a central banking system in the United States cannot be endowed with as full a measure of powers and functions as is enjoyed by the central banks of Europe, and that our political

and social conditions force us to accept a vastly more complicated system of administration than that governing similar institutions in the Old World, must be accepted as an uncontrovertible fact. Hence we must resign ourselves to having a system of more restricted powers and weaker organic structure grappling with problems and responsibilities immeasurably weightier than those of other central banks.

These difficulties have led some timorous minds to favor a Federal Reserve System without a will; a system of gigantic strength without initiative or power; an emergency system that, instead of leading, would more or less automatically follow the wishes and requirements of business and finance. Such a system would inevitably lead either to Wall Street domination or chaos, with complete political control as the ultimate outcome in both eventualities. It would be better for the country to have no Federal Reserve System at all than such a system.

A Federal Reserve System that is fit to survive and worth preserving must have a will of its own and power, within its legal limitations, to assert it. But this will must spring, not from the urge to dictate or dominate, not from a desire to meet political exigencies, or the wishes of any particular class, but from a thorough and unbiased search of what the best interests of the country as a whole require. This in itself is a task of infinite difficulty requiring the best minds and bravest souls the country can produce. Is the Federal Reserve System, as at present designed, able to render service in its organization attractive to such men? And furthermore, the duty of fashioning the Federal Reserve System's policy having been lodged in many minds and many places, does the System, as at present designed, possess a machinery that, assuming the highest intelligence and motives in all parties concerned, can possibly produce conclusions and actions as wise and as prompt as are essential for the country's safety and welfare?

It is to these questions, which touch upon the most serious

defect of the Federal Reserve System, that we now propose to address ourselves.

It ought to be distinctly understood, however, that the adoption of most of the recommendations made in this first part of the chapter, in so far as they involve the vesting of additional powers in the Board, could not be hazarded except as a part of a larger plan involving some such changes in the organic structure of the System as are now to be discussed.[1]

One of the striking points of strength of the Reserve System lies in its weakness. This paradox means that the strength of a system of regional banks consists in engendering in the minds of the people a comfortable feeling of protection against the dangers of an autocratic central administration. In this respect the Reserve System is to be preferred to that which was provided by the National Reserve Association Plan and my "United Reserve Bank" proposal. There is no doubt that both, if enacted, would have offered easier and more tempting targets for political attacks. This political superiority of the Reserve System cannot be too highly appraised, although it is, at the same time, the System's greatest weakness.

In making the Reserve Board the link that was to "join together" what Congress had gone to such pains to "put asunder," the law placed upon the Reserve Board a task the difficulties of which, it seems, are not sufficiently appreciated. Moreover, the Act, as finally agreed upon, constituted a compromise between the widely opposing views prevailing in the Senate and the House—views which resulted in the adoption of a terminology sufficiently indefinite to enable both sides to cherish the belief that, in the administration of the law,

[1] Even if these changes were adopted, an "immediate credit" check collection plan should not be attempted until a record of several years has proved the Board capable of dealing with the rediscount rate problem promptly, efficiently, and solely on economic grounds.

their conceptions would ultimately prevail. As a consequence, the Reserve Board, when undertaking the responsibility for the operation of the System, accepted a trusteeship exposing it to attacks from both testators and co-legatees. Obviously the guiding thought in the minds of some of the testators was to confer far-reaching powers of control upon the "Reserve Board, as the instrumentality of the government," while it seems to have been the aim of other parties joining in the will to stress the autonomy of the reserve banks and to give them a large measure of independence. That in these circumstances the legatees cannot always agree as to the proper interpretation of so inconsistent a document was shown by the clash that occurred in August, 1927, between the Reserve Board and the Federal Reserve Bank of Chicago. The ambiguity of the law was so glaringly illustrated by that controversy over the meaning of the provision in the Act relating to the establishment of the discount rates of the reserve banks that it was thought desirable to deal with the incident rather fully in a postscriptum which appears as Addendum 1. Suffice it to state here that, although the clause in the law relating to this fundamental power leaves the question as to the authority of the Reserve Board and the district banks unsettled and subject to amazingly divergent opinions on the part of the so-called "framers of the Act," the best practicable course in the author's judgment is to leave the relevant clause of the Act just as it stands to-day. Any attempt to place the power unequivocally and exclusively in the hands of either the Reserve Board or the reserve banks would only aggravate the difficulties of the situation. Absolute power in the hands of the Board would make the Reserve System a politically controlled central bank, which would be unacceptable to the majority of the people and abhorrent to the conservative elements of both political parties. On the other hand, undisputed autonomy of the reserve banks in the question of rate making would render a concerted dis-

count policy of the Reserve System an impossibility, and reduce the Board to a position of impotence.

A regional system that is to operate successfully must remain a balanced system. That is to say, the Reserve System must be under the leadership and direction of the Reserve Board; *but* with a generalship on the part of the Board which does not rest on the assertion and bureaucratic or dictatorial exertion of its legal powers but on the reserve banks' full confidence in the competence, fairness, and impartiality of the Board, and on the clear recognition by the reserve banks of a coördinating leadership by a Board seeking their harmonious coöperation as indispensable to the successful and undisturbed functioning of the System. For the enduring success of the System, a Board enjoying the unreserved confidence of the reserve banks is thus a fundamental prerequisite, a Board whose leadership the reserve banks will accept voluntarily, as a matter of self-interest, instead of submitting to it grudgingly, or of openly resisting it in defense of their legal rights.

The essential question then, is: What can be done to preserve or strengthen the authority and competence of the Board? Perhaps, in order to answer this question intelligently, one might also put it inversely by asking: What is there that stands in the way of the development to the fullest possible extent of the Board's prestige and competence?

In all discussions preceding the passage of the Federal Reserve Act it was stressed as one of the fundamental principles that, so far as possible, the System should be kept free from political control. It was stated as one of the foremost duties of the Board that, as a judicial body, it should perform its functions independently of political considerations. In view of the fact that the reserve banks were to be fiscal agents of the government, and in keeping with the general sentiment of the country that a body exercising functions of such national importance should operate under a certain measure of government control, it was inevitable and proper that the Treasury,

in some way, should be represented on the Reserve Board. Yet, business men and economists are likely to agree that it was a mistake to make the Secretary of the Treasury the chairman of the Reserve Board.

The history of the last decade has furnished impressive illustrations of the dangerous consequences following from the subordination of the policies of central banks to the domination of finance ministries. While it is fully conceded that, under the stress of war, central banks cannot hope to preserve their political independence, it remains true all the same that, in times of peace, every effort should be made to keep central banking and government finance separate. Secretaries of the Treasury, like ministers of finance or secretaries of the exchequer in other countries, are partisan members of an administration in power. Dominant political parties have always been known to pray and work for "good times" and "prosperity" during the period in which they are in power. The Reserve System, on the other hand, must be willing to check a wave of unhealthy over-speculation threatening to disturb the stability of prices and credit, and bound ultimately to inflict severe losses upon the country. In a timely grasp of dangerous conditions of this type and in a fearless handling of situations as they arise lies the success or failure of the Reserve System. It is impossible to hope that a party administration would be found willing to undertake the painful and ungrateful task of temporarily checking "prosperity"—even though it were only sham prosperity—for the purpose of preventing a grave disaster threatening to occur in the future. Conditions such as prevailed in 1919 illustrate what we have in mind, and such conditions are bound to recur from time to time and lead to violent economic disturbances and the consequent threat of increased political interference and encroachment.[1] If the System is to steer an even course, one which

[1] The stock-exchange panic of 1929 has further illustrated this point since the above was written (see Addendum II).

the reserve banks will unhesitatingly follow, the tiller ought to be in the hands of a politically independent Reserve Board.

The fact that the Secretary of the Treasury is chairman of the Reserve Board gives him, however, in addition to the prestige to which his office entitles him, a dominant position in discussions of the Reserve Board's affairs, and as the prestige and importance of his office increase, that of the governor loses in importance, not only in the estimation of the public, but also in that of his colleagues and the officers and directors of the reserve banks. Moreover, as we have seen in preceding chapters, the President's power to reappoint or dismiss members of the Board, and to make or unmake its governors and vice governors, is one in the exercise of which he is, naturally, largely guided by his Secretary of the Treasury, and one which at times has made it doubly difficult for Board members to maintain the independence of the Board against the subtle influences of party politics. Fourteen years of actual operation, moreover, have demonstrated the incontestable fact that the Secretary of the Treasury cannot possibly find the time to attend regularly the Board's prolonged meetings. The head of our Treasury is in a position to appear at such meetings only at rare intervals, when matters of particular importance are to be decided, or when critical situations arise; and on such occasions he is hastily posted and frequently forced to act without the benefit of such detailed knowledge as would result from closer contact with the Board's affairs. It ought to be stated emphatically, however, that all of this does not imply the slightest criticism of any of the Secretaries of the Treasury who, since the organization of the Reserve Board, have acted as chairmen of the Board. In general, they have conscientiously tried their very best to meet justly the embarrassing requirements of their dual position. A political chairman of a non-partisan Board is an incongruity imposing upon the incumbent a well-nigh impossible task.

The influence of the Secretary of the Treasury is further

enhanced by the *ex officio* membership of the Comptroller of the Currency, who administers his own department as an appointee of the Treasury and under its control. The unfortunate fact that the Conference Committee permitted the Comptroller's office to be represented on the Board as a bureau of the Treasury, instead of placing it under the authority of the Reserve Board, has led at times to a grave undermining of the Board's position. As the law stands at present, the Board, including the Comptroller, may pursue one policy with regard to the affairs of member banks, while the office of the Comptroller may pursue another. One single member of the Board is in a position to block progress where common policies are involved. The Treasury and the Comptroller's office represent two independent powers within the Board with definite purposes of their own, thus weakening the Board's authority and aggravating its difficulties in developing and enforcing its own policy. Highly exasperating conditions have not infrequently resulted from this unfortunate feature of the law.

Careful observers have also noticed a tendency on the part of political leaders to consider the Reserve System as an instrumentality of the government. From the beginning, achievements of the Reserve System in operation have been hailed as accomplishments of the party in power, or of a Secretary of the Treasury. Some "administrations" have even gone so far as to claim credit for the lowering of discount rates, and Secretaries of the Treasury have spoken for the Reserve Board as if the policy of the Board were a concern of the President's Cabinet.

The future of the Reserve System depends very largely upon the country's ability to secure for service on the Board men of the highest type willing to make the sacrifices involved in accepting membership. The importance, therefore, of making the office attractive to such men need not be stressed. Under the conditions just described, however, it is obvious

that to a large number of prominent citizens, admirably suited for service on the Board, membership has not proved tempting. Yet, the factor which more than any other has lessened the willingness of such men to serve has been the realization that a fearless and conscientious discharge of their duties might expose them to the ire and vengeance of senators, whose wishes they might be forced to disregard. It was in order to elucidate the seriousness of this latter point that some of the incidents in the careers of earlier members of the Reserve Board have reluctantly been touched upon.

With a view to securing for the Federal Reserve System a management that may include the best available talent of the country, a management organically so constituted that it may be possible for it to grasp and master the trying task of uniting the twelve autonomous Federal reserve banks in harmonious and efficient coöperation under a common plan, the following recommendations are presented:

One. That the Board itself appoint its governor and vice governor and that the Board be left free to adopt a system of rotation in the office of governor by having every appointive member serve during the last four years of his term, first, two years as vice governor, and second, two years as governor. This change would necessitate the creation of the position of an executive secretary of the Board to act as the "permanent undersecretary."

Two. That the governor of the Board be its chairman; the vice governor its vice chairman.

Three. That the Undersecretary of the Treasury, instead of the Secretary of the Treasury, serve as *ex officio* member of the Reserve Board. This officer should be better able than the Secretary to find time to attend the meetings of the Board, and the Undersecretary could well serve without acting as chairman of the Reserve Board.

Four. That the office of the Comptroller of the Currency, in so far as it deals with the affairs of the member

banks, be administered under the supervision, direction, and control of the Federal Reserve Board. (It is an open question whether it would not be better to remove the Comptroller entirely from the Board. As in the case of the Secretary of the Treasury, experience has shown that the heavy responsibilities of his own office render it practically impossible for the Comptroller to attend the Board's meetings regularly and to keep fully in touch with its intricate problems.)

Five. That a member of the Reserve Board, who has been confirmed by the Senate at the time of his first nomination, may be reappointed by the President without the President's obligation to resubmit his name for a renewed confirmation by the Senate. (It is, of course, realized how desperately small are the chances of the acceptance of this proposal by the United States Senate. It is submitted, however, on the strength of its merit, as the author is convinced that there is nothing that would more effectively increase the independence of the appointive members, and render the position of a Reserve Board member less hazardous, than the adoption of this suggestion.)

While the changes here proposed would tend greatly to enhance the independence and prestige of members of the Board, and thus render their position more attractive, they alone would not completely solve our problem. If a smooth and effective operation of the Reserve System is to be assured, a further important modification seems to be urgently needed.

In order to command a free and willing acceptance of the Reserve Board's leadership on the part of the reserve banks, it is of paramount importance that the reserve banks be convinced of the Board's intimate knowledge and sympathetic understanding of their affairs. If the country is to enjoy the full benefit of the Reserve System, the Board must act as a link connecting the reserve banks, and not as an instrument designed to keep them asunder; not as an antagonistic, but as a harmonizing body. Some students seem to think that the

future of the Reserve System would best be assured if there were a Board of overshadowing importance at Washington, with executives of small importance in the reserve banks. Others seem to take the opposite view and envisage the Reserve System of the future as governed by great leaders in the reserve banks and a body of unimportant government officials at Washington. The truth of the matter is that a development along either of these extreme lines would be fatal. Congress, in the long run, would not permit the Reserve System to be dominated by the reserve banks, while the country would not tolerate a central banking system under autocratic governmental control. If enduring peace and progress are to be assured, we must have the biggest possible leaders both at Washington and in the reserve banks and, instead of matching the Board and the reserve banks against one another, we should provide for a bridge that will unite them. The suggestion that we have in mind, and which we should like to add to the five already made, is to change the Federal Reserve Act so as to provide:

Six. That the reserve banks be given the power, subject to the approval of the President (who might reject the list and ask for the submission of other names), to delegate four men to the Reserve Board, each of these to be elected by the combined directorates of a group of three reserve banks. These delegates would represent the three reserve banks electing them in stated monthly meetings of the Reserve Board, and at these monthly meetings they would have the privilege of voting. At these regular meetings (or at special meetings, if required), the discount rates of the reserve banks would be submitted "for review and determination," and the open-market policies of the System would be dealt with.

The benefits which might be derived from this modification are self-evident. If we accept twelve reserve banks as a finality, it will always remain a well-nigh impossible task for eight Board members individually to acquaint themselves with

the conditions prevailing in twelve geographically remote districts, and to exert the right type of influence upon the operations of the twelve banks merely by communications with the twelve governors and the twelve reserve agents at these banks. If, sitting with the Board at its important meetings, there were four men whose particular duty it would be to keep themselves advised with regard to the affairs of the three reserve banks whose representatives they would be, the Board would find its problems greatly simplified, and it would be easier for it to reach prompt and intelligent decisions concerning questions in the consideration of which knowledge of local conditions plays an important part. From the adoption of the modification here proposed, a further highly important advantage would ensue, namely, that with these four representatives of their own associated with the Board, the reserve banks would have a firmer assurance that their problems were fully understood. As a consequence, they would accept the decisions of a Board so constituted willingly and without hesitation. It may be stated with confidence that, had four representatives of the reserve banks joined in the deliberations of the Board when, in August, 1927, the clash between the Board and the Federal Reserve Bank of Chicago occurred, the trouble would have been avoided. In that situation, the Reserve Board, with full knowledge of prevailing conditions, would either have abstained from imposing its will or, had it reached the conclusion that a change of the Chicago discount rate was imperative in the common interest, the Federal Reserve Bank of Chicago would then have accepted the findings in a spirit of willing acquiescence in the Board's better knowledge and judgment.

While in view of the political hazards and the personal sacrifices involved, a desirable man might be unwilling to accept office as an appointive member of the Board, it may safely be assumed that he could hardly refuse to serve, if he were called upon by the directorates of three reserve banks

to represent them at Washington. Such a choice would be so impressive an evidence of the confidence reposed in him by an important group of prominent members of the banking and business fraternity, that a man thus delegated would find it very difficult to decline. While these four men would be chosen subject to the approval of the President, they would otherwise be free from political hazards; and they would receive an adequate salary, to be fixed and paid by the reserve banks, in a manner similar to that which is now in force in connection with the salaries of reserve agents. Moreover, service as a representative of reserve banks would not entail living in Washington. On the contrary, it would be desirable for the representative to remain a resident of the territory tributary to the three banks he represents and, instead of living in Washington, to go there from time to time to participate in the deliberations of the Board. Such a representative of the banks should be sought from among men not too much advanced in years who would be willing to stand the strain of frequent journeys and be likely to serve for a long term.[1]

No matter how splendidly men may be equipped at the time they assume membership on the Federal Reserve Board, tied down to their desks by daily duties in Washington, they are bound to lose touch with the ever-changing local conditions of the country. A system providing a means of carrying the country's problems to Washington through the medium of expert "ambassadors" in constant touch with their home territory would seem to offer advantages that do not require any further elaboration.

The skeptics' obvious reply to this proposal is that, while it may be highly desirable, it is "politically impossible." But why should it be "politically impossible," if we bear in mind that prominent leaders of both parties originally favored

[1] Terms of service of ten years might be decreed with probability of reappointment upon expiration of the term in a manner analogous to conditions of appointment of Federal Reserve Board members.

like schemes? It will be remembered that, on the Democratic side, Mr. Glass, in his first drafts, made a very similar proposal for the constitution of the Reserve Board, and that Dr. Willis, in *The Federal Reserve System*,[1] makes the following observation:

> Undoubtedly experience has demonstrated that the present method of constituting the Federal Reserve Board is unsatisfactory. It has fallen constantly under the supervision of politicians, and even when not under their influence has been constantly fearful that it would be obliged to yield to them. The fact that it has not yielded in the matter of appointments is greatly to its credit, but represents a condition which probably cannot be very long maintained. *All this means that the present position of the Federal Reserve Board is not one which can be regarded as permanent if our banking system is to function in safety. The question seriously raised is whether something like the plan at first proposed in the federal reserve act, whereby the bankers themselves would have been given a partial representation on the Board, may not have to be introduced, or whether, if public opinion should continue adverse to such an arrangement, it will be possible to obtain a composition of the Board which shall be far less influenced by political considerations than at present.*[2]

As to the Republican attitude, it will be recalled that the Aldrich Bill went even further in the direction now proposed by permitting the National Reserve Association's branches to have, not only representation on the central board, but the preponderating voice in its affairs.

In his message to Congress of December 21st, 1911, on "The Financial Condition of the Treasury, Needed Banking and Currency Reform and Departmental Questions," President Taft when commenting upon the proposal for the creation of the National Reserve Association, made the following remarks:

[1] *Op. cit.* pp. 1498–99.

[2] Italics are mine—*Author.*

> Exactly how the management of that association should be organized is a question still open. It seems to be desirable that the banks which would own the association should in the main manage it. It will be an agency of the banks to act for them and they can be trusted better than anybody else chiefly to conduct it. It is mainly bankers' work. But there must be some form of government supervision and ultimate control, and I favor a reasonable representation of the government in the management. I entertain no fear of the introduction of politics or of any undesirable influences from a properly measured government representation.

Here we have, then, the conservatives of both dominant political parties of one mind with respect to the advisability of having bank representation on the central board. As a matter of party expediency, however, through the influence of the Bryan faction, the Reserve System came to be branded with the stamp of a purely governmental board. It may be timely to remind the reader of what Mr. Bryan jubilantly wrote after he and his friends had succeeded in winning President Wilson over to their side:

> The provision in regard to the Government issue of the notes to be loaned to the banks is the first triumph of the people in connection with currency legislation in a generation. It is hard to over-estimate the value of this feature of the bill.
>
> In the second place, the bill provides for Government control of the issue of this money—that is, control through a board composed of Government officials selected by the President with the approval of the Senate. This is another distinct triumph for the people, one without which the Government issue of the money would be largely a barren victory.[1]

That the "triumph for the people" has had unfortunate consequences for the Reserve System is proved by the history of the Board's record in the first fourteen years of the law's operation.

The Reserve System can live down the government note issue concession if, from its acceptance, we do not draw

[1] From letter to Carter Glass, dated August 22nd, 1913, reprinted in Willis, *op. cit.*, p. 303.

the conclusion that the issue of the government's money necessitates, as a logical consequence, absolute governmental control of the Board; it can live down its difficulties of over-decentralization and of unbalanced "balanced powers" if the Reserve Board be given a greater political security and the assurance of an uninterrupted admixture of experts fully familiar with the detailed operations of the reserve banks. In its present form, the Act is bound to lead to the gradual deterioration of the Board, and finally of the System. On the other hand, the remedy here proposed is entirely in keeping with the theory upon which the Federal Reserve Act was built. The Act provides to-day that, in the reserve banks, two-thirds of the directors shall be elected by the member banks and one-third by the Reserve Board. What is now proposed is simply the application of this same theory to the composition of the Reserve Board. Just as, in the operating section of the System, the majority is elected by the banks, with a minority representation of the central controlling section, so it is proposed that, in the central controlling section, the reserve banks, as the operating section, shall have a minority representation. Thus, of a total number of twelve, two-thirds would consist of appointees of the President (six appointive members of the Board, plus the two *ex officio* members, as the Act provides to-day) while one-third would be composed of the four delegates appointed by the reserve banks, subject to the approval of the President.[1]

Some critics may insist that a Board of twelve members would be too large. It may be confidently asserted, however, that as long as it is necessary to have a body representative of a cross-cut of all sections of the country, and since it is, therefore, impossible to have a very small executive body of possibly three members, it is better to have a group large enough to be forced to operate under parliamentary and business rules, than

[1] Among the footnotes to the juxtaposition in Chapter VIII, and in Addendum III, a suggestion will be found for the improvement of the system of electing the directorates of the reserve banks.

a Board of seven or eight in which more informal methods of procedure and personal courtesies and considerations easily may lead to procrastination and inaction.

The remedy here proposed would, it is true, necessitate action by the Senate involving a certain lessening of its own powers. Among the senators whom it has been my good fortune to know there are, however, many who are keenly alive to the injuries inflicted upon the country by the reckless abuse of senatorial privileges on the part of some of their egocentric colleagues. The proposal here made would, no doubt, meet with determined resistance in the Senate, but if the seriousness of the situation were fully realized by the country, and if a demand for remedial action were carried along by a strong wave of public opinion, there would be good reason to expect effective support by those members of the Senate, of whom I know Mr. Glass to be one, who are citizens first and senators afterwards. No attempt to tinker with the Federal Reserve Act should be hazarded, however, until a strong administration, certain of adequate Congressional, if possible bi-partisan, support, and with a full grasp of the problem, will sponsor such a bill with a firm determination to carry it through. The earlier the moment arrives when amendments of the Act as here suggested can safely be launched, the better for the System.

The thrill of being given the unequalled opportunity of taking part in laying the foundation of the giant structure of the Reserve System, the patriotic impulse to serve the country during the War, and the fascinating challenge to lend a hand in the struggle with the titanic problems of the reconstruction period, brought men of exceptional talent and rare unselfishness into the Reserve System and made them cling to their tasks with unexcelled devotion through long, trying years. Many men of that period and of that fibre are still on the bridges of their crafts, in Washington and in the Federal reserve districts, lending inspiration to their officers and crews,

and still guided by the principles and standards born of the spirit of those years. Yet, as we move away from the period of the System's first beginning and early growth, the stimulating influences of those times begin to wane, and it is becoming all the more important for us to do everything in our power to make service on the Board and in the reserve banks as free as possible from adverse influences.

The object in writing this book was to show whence we came, whither we are drifting, and by what fairly simple means we can avoid dangerous rocks now threatening our course. There is no hope, however, that adequate remedies may be secured unless both political parties realize that, in this matter, they have not only equal claims of authorship, but also equal responsibilities concerning the future fate of the System.

An account of the contributions made to the Act by particular persons is of negative rather than of positive importance, because it is of enduring significance only in so far as it tends to show that the Federal Reserve legislation was the result of the efforts of many individuals rather than of any single mind or party.

Through thousands of years, the old parable of King Solomon and the two mothers has not lost any of its strength and beauty. True parenthood shows itself not in a selfish desire to own the child, but in an unselfish desire to see the child live.

If both political parties can be counted on to vie with one another in making their parenthood true in this sense, the future of the Reserve System is secure.

Yet, in the final analysis, it is the people who are the guardians of the Reserve System. Congress merely reflects their thoughts. The people themselves, like understanding parents, must exercise a constant vigilance over the child's growth, and stand determined to ward off any influence that tends to mar its development, or to menace its life. The Reserve System will be in danger whenever a coming generation relaxes in the consciousness of that guardianship.

ADDENDUM I

THE CHICAGO INCIDENT: A POSTSCRIPTUM

IN August, 1927, a controversy developed between the Reserve Board and the Federal Reserve Bank of Chicago. This controversy was occasioned by the Reserve Board's surprising action in establishing a new discount rate for the Chicago Bank before the Chicago directorate had submitted its rate for "review and determination." While for a time the disagreement had reached so critical a point that a judicial determination of the question seemed to offer the only way out, the opposing factions finally came to realize the unwisdom of such a course. Sober second thought also came to perceive that it would be most undesirable to request Congress to make a clear-cut legislative distinction between the powers of the Reserve Board on the one hand and the prerogatives of the reserve banks on the other.

The resolve to leave the matter in *statu quo* was undoubtedly well conceived, as a clear decision in favor of either side would have been fatal.

To deprive the Board of all power to fashion and, if need be, to enforce the Reserve System's common discount policy would have amounted to reducing the Board to a position of insignificance and impotence; it would, moreover, have created anarchy among the reserve banks unless the most important of them should assume a dominant leadership. This, in turn, would at once have led to jealousies and protests on the part of the other Federal reserve banks and, in the end, would have brought about Congressional interference. On the other hand, to give to the Board a broad and clearly expressed power to establish the reserve banks' discount rates would have destroyed the theory of the autonomy of the twelve reserve

banks. In effect, this would have been tantamount to the creation of a politically controlled central bank, a development abhorrent to the majority of both parties.

The whole incident merely reveals one of the structural weaknesses of the Federal Reserve System—a weakness clearly foreseen at the time of its genesis and of the formulation of its functions, and one which cannot now be remedied by throwing the balance of weight overwhelmingly on either side of the scales. The "framers of the Act," as the record shows, were thoroughly baffled by this problem, which required nothing less than the finding of a formula providing at one and the same time for the preservation and the destruction of the autonomy of the reserve banks. A study of the relevant sections in the several drafts of the Glass Bill and the Senate Bill shows that the authors floundered about from one extreme to the other until they finally adopted the language embodied in the Federal Reserve Act which, in practical effect, left the question of final authority wide open. Thus, if we examine the drafts in their historical sequence, as published by Dr. Willis,[1] we find that, in the first two drafts of his bill, Mr. Glass provided that the "Federal Reserve Commission," later on termed the Federal Reserve Board, should have absolute power "to establish each week, or as much oftener as required, a rate of discount which shall be mandatory upon each Federal reserve bank." It is true that, at that time, the bill provided for a Federal Reserve Commission with three classes of members, one group of which was "to consist of Federal reserve representatives chosen by Federal reserve banks." [2]

[1] It is significant that, in the first draft, the Federal Reserve Commission consisted of three groups:

1. Three *ex officio* members.
2. Three members to be appointed by the reserve banks.
3. Three members to be appointed by the President; of these, one was to be the president, one to be the vice president, *and one to be the secretary of the Commission.*

The italics are mine—*Author.*

[2] *The Federal Reserve System*, pages 1531 to 1594.

This provision made it safer for, and more acceptable to, the reserve banks to have the power of establishing the discount rate vested in the Reserve Board.

The third draft, the so-called *First Print of the Glass Bill* still contained the same language for the fixing of the discount rates, with this drastic change, however, that the power to establish the rates was vested in a Reserve Board of seven, of whom *four* were to be appointed by the President, while *three* were to consist of two Cabinet members and the Comptroller of the Currency *ex officio*, the representatives of the reserve banks being completely eliminated. Thus the power to fix the discount rate was to go to a central body which was bound to be under complete political control.

The next print, the *Glass Bill as introduced in the House*, contained the same extreme provision for the composition of the Reserve Board, but suddenly transferred the power to establish rates from the Board to the reserve banks, which were to have power "to establish *each week, or as much oftener as required, subject to review and determination of the Federal Reserve Board, a minimum rate of discount, etc.*"

The final draft contained the same provisions except that the word "minimum" with regard to the rate of discount was eliminated.

The Senate Bill provided for a Reserve Board of seven members, of whom six were to be appoined by the President, while the Secretary of the Treasury was to be the only *ex officio* member; it contained a clause giving the reserve banks power: "To establish *from time to time*, subject to review and determination of the Federal Reserve Board, rates of discount to be charged by the Federal reserve banks for each class of paper which shall be fixed with a view of accommodating commerce and business." This Senate clause was accepted by Mr. Glass in conference, and now forms part of the Federal Reserve Act. The compromise agreed upon "in conference" included, however, the highly regrettable provision to reduce

the number of the appointive members of the Board from six to five, and added the Comptroller of the Currency to the Board as the second *ex officio* member.

From the foregoing, it will be seen that all of the Glass bills gave control over rate making to the Board; for, even in the bill as it passed the House, the fact that the reserve banks had to submit their rates "for review and determination each week or *as much oftener as required*" [1] meant that, in effect, the Board had the undisputed power to determine the rates. The language of the Federal Reserve Act, as finally adopted, restricted the Reserve Board's power to reviewing and determining the rates, as and when the reserve banks would submit them "from time to time." This is a clear indication that the law wished the reserve banks as far as practicable to exercise the power to initiate the rates, while the Board was to determine them after the rates had been submitted for review. There is nothing in the Act, however, that would prevent the Reserve Board, when reviewing and determining a rate, from establishing it as valid for a limited time and thus forcing the reserve bank to resubmit it at the expiration of a given period. By adopting this procedure, the Board would be in a position to fix the rates if it should choose to do so because, once submitted, the rates are not subject solely to "confirmation" but also to "determination" by the Board.[2]

The Board can thus find sufficient authority in the Act to dictate rates; and the authority to assume such powers in time of need the Board must not surrender. But a wise Board will use the utmost discretion in exercising this right. A strong and competent Board (with this power in its pocket) will find no difficulty in commanding a following on the part of the reserve banks when, after consultation with them or with the Advisory Council, it explains what the composite picture of all the districts combined indicates as the

[1] Italics are mine—*Author.*

[2] The Board openly followed this procedure for a time in the earlier years.

proper policy to be pursued for the benefit of the country as a whole.[1]

Here we touch the heart of the question, the problem dealt with in Chapter XII, that is, the question of the competence of the Board. If the reserve banks are satisfied that the Reserve Board's conclusions are sound, based upon a comprehensive study and grasp of all phases involved, and reached with the country's best interests at heart, they will follow the Board willingly and without any thought of challenging its authority; but, if the Board's acts are high-handed or politically inspired, or if they exhibit a lack of adequate knowledge of facts and conditions, clashes between the Board and the reserve banks are inevitable.

The solution of the problem under discussion cannot be found by giving the coveted power entirely to either one of the two parties; any such step would leave one side disgruntled and tend to increase the antagonism and widen the cleavage between two forces which must coöperate with one another if the System is to enjoy permanent safety and success.[2]

When the clash between the Board and the Reserve Bank of Chicago occurred, Senator Glass, Senator Owen, and Dr. Willis at once published statements containing their views with regard to the controversy. Giving abstracts of their utterances, we find Senator Owen, whose wording of the section in the Senate Bill had prevailed, summing up as follows:

> . . . The present controversy turns on the point whether the Federal Reserve Board shall exercise control of the fixing of the rates. *I am emphatically in favor of the exercise of this power by the United States Government, and a fair interpretation of the Federal Reserve Act will show that this was the intention. . . . If there be any doubt, the doubt should be removed by an amendment that would give this power to the Government. . . .* [3]

[1] This does not necessarily mean uniform discount rates, but permits of differentiation between the districts with a reasonable allowance for their varying conditions and needs.

[2] As more fully explained in Chapter XII.

[3] The italics are mine—*Author.*

Expressing views diametrically opposed to those just cited, Senator Glass permitted himself to be quoted as follows:

> *It was the obvious spirit of the Act to confide to each Federal Reserve Bank initial authority to establish rates because of the banks' necessarily superior knowledge of regional conditions, and neither the spirit nor the text of the Act sanction interference by the central Board except in extraordinary circumstances.* . . . If the rediscount rate of the Chicago Reserve Bank is either "dangerously low" or so unreasonably high, that the bank fails in the requirement that it shall accommodate commerce and business, then the Board at Washington may find justification in the law for its action. I am not sufficiently familiar with conditions at Chicago to form any opinion on this point. However, I am decidedly apprehensive that this action of the Federal Reserve Board is, *and was intended to be, a long stride in the direction of making the Federal Reserve Board a central bank, with the reserve banks as mere branches, which is as far from the real intent of the law as anything could possibly be.* . . . *I think Congress should promptly and peremptorily cure this situation by legislation which nobody will misinterpret.*[1]

Dr. Willis, in an article published by the *New York Sun* on September 10th, 1927, gives his views as follows:

> . . . The present effort to dictate rates of reserve banks naturally fans this smoldering unrest into a flame. As a matter of fact, it would be an immense change in the independence as well as in the actual working of the reserve system were there to be a central rate-making body at Washington. *The system was originally established with the intent to avoid such a substitute for a central bank and with the definite belief that rates would be locally established and under local control, the centralizing function at Washington being merely that of harmonizing such rates. Local reserve banks cannot afford to give up this autonomy. Were they to do so, they would become nothing more than branches of the central organization, or at times they might really be branches of other banks, which had succeeded in*

[1] The italics are mine—*Author.*

acquiring a dominating power in Washington. That is the danger at the present time. . . .[1]

If a board of directors had no other recourse it should, however, have the courage to resign office rather than to assist in the violation of the fundamental principles on which the reserve system is organized. There is a principle here that is much more valuable and vital than any mere rate itself, the principle of local and financial independence, originally recognized in the reserve act, but requiring constant vigilance as the price of its maintenance.

It is amusing to contrast the views laid down in this last article with the thoughts expressed by Dr. Willis five years ago in his book *The Federal Reserve System*, wherein we find the following paragraphs:[2]

Thus, since the Board could, at intervals of one week only, approve or disapprove proposed discount rates, it was practically in the position of having a continuing veto upon rates, since if a bank recommended the same rates it already had in effect, the Board by vetoing them could compel the bank either to suspend its discount business or else to file new rates. Thus the Board practically took to itself a substantially larger power than it had originally been granted by the framers of the act, and yet in so doing the action of the Board was probably *not only wise but necessary*. Unless there was to be communication and discussion among the reserve banks, it was only through the exertion of a very decisive power by the Board itself that such effort could be made to succeed. Hence it seemed to be fully necessary for the Board to act constantly as a clearing house for rates, data, and suggestions concerning the fixing of discount levels, or else to assume practically the *functions of a central bank in so far as they related to the discount rate*. . . . The general question whether it was or was not desirable for the Board to exercise the powers which it thus in the circumstances usurped never came to an issue in any overt

[1] The italics are mine—*Author.*

[2] *Op. cit.*, pp. 892–893.

way, and this, as already stated, was probably because of the recognition on the part of all concerned *that such an extension of the intent of the Reserve Act was almost unavoidable if the work of the system was to proceed smoothly.*[1]

As quoted above, the utterances of the "framers of the Act" furnish an impressive illustration of the violence done to a quiet and judicial discussion of questions affecting the Federal Reserve problem by the ever-present injection of the argument of "the spirit of the Act," a special and quasi-monopolistic knowledge of this spirit being confidently claimed by each of the "authors of the Act." But one is tempted to ask, what is this "spirit of the Federal Reserve Act," and which of the authors may justly arrogate to himself the right of interpretation? Is it Senator Owen or the Glass-Willis combination, and at what moment in the chameleon's life did it show its official color? In which of its many radically different forms did it make its spirit known? With what reckless levity the original "intent" of Congress or the "spirit of the Act" is conjured up is readily seen from the quotations just cited. Both Glass and Willis seem to have completely forgotten that their bills, in every form submitted, gave the Federal Reserve Board the very rate-making power which they now denounce as a step in the direction of a central bank, and as a perversion of the original spirit. Willis more recently states that the System was originally conceived "with the definite belief that rates would be locally established and under local control etc." There is no evidence whatever in the earlier drafts just cited that would bear out this assertion. Indeed, it is most amusing to find that, if Glass and Willis have any foundation for their claims of reserve bank autonomy in the question of rate-making, the only place from which they can derive it is Owen's Senate Bill. And Owen says that the rate-making power under his bill is vested in the Reserve Board! To cap the climax, Senator Glass, when Secretary of the

[1] The italics are mine—*Author.*

Treasury, wishing to curb a reserve bank in what he now terms a "desperate post-war emergency" in December, 1919, invited the Attorney General to give him a legal opinion as to the Board's powers in the premises; and this legal opinion (see Appendix Thirty-Six) sums up the case as follows:

> I am of the opinion that the Federal Reserve Board has the right under the powers conferred by the Federal Reserve Act to determine what rates of discount should be charged from time to time by a Federal reserve bank, and under their powers of review and supervision, to require such rates to be put into effect by such bank.[1]

A detailed account of this strange record of confusion has been given, because some important lessons may be drawn from it. The story illustrates strikingly what may occur when Congress finds it impossible to formulate in precise terms a law which will express a compromise of conflicting views; and when the law is to create a so-called "balanced position," involving an authority divided between two forces, neither of

[1] Inasmuch as I left the Board in August, 1918, and the Attorney General's opinion was not obtained by Secretary Glass until December 9th, 1919, I have no personal knowledge of what were the causes of the "desperate post-war emergency." We find some indications of these causes, however, in Governor Harding's *Federal Reserve System*, pp. 157 and 158. It appears that after the conclusion of the War several reserve banks were anxious to increase their rates. It was feared, however, that such action would interfere with the placing of the Victory Loan and, as a consequence, no advance in rates was made until November, 1919, after the Victory Loan of $4,500,000,000 had been successfully placed in the month of June. The increase in discount rates, which took place in November, involved an advance of only ¼ per cent to ½ per cent through increase of the reserve banks' rates for 90-day war paper from 4¼ per cent to 4½ per cent and 4¾ per cent. There was insistent pressure, however, on the part of some of the reserve banks that rates should be further increased so as to combat the mounting tide of inflation then under way. The Treasury, having in mind an impending issue of certificates of indebtedness, firmly opposed a further advance in rates, and no further increase took place until after the sale of the Treasury certificates on December 15th, 1919. Subsequent events warrant the belief that the interests of the country would have been better served had inflation been brought to an earlier halt, and that the "desperate post-war emergency" resolved itself into the Treasury's determination to continue its cheap money policy.

which is to be given complete control, the perplexities of the case become still further aggravated. Where, as in the Federal Reserve Act, a divided authority, inadequately determined, forms the most essential part of the fundamental structure of a law, satisfactory operation of that law must needs depend upon the sagacity with which discretion is used by the bodies set up to administer it.

This, in turn, indicates the necessity of securing for the administrative boards men of the highest character and competence, so that the discretion with which they are clothed may be exercised without bias and with independence, courage, and intelligence. It also means that Congress, after having left undefined what it found itself unable to define when writing the law, should leave as undisturbed as possible the men in whose hands the administration of the law is placed. It is imperative, therefore, that individual members of Congress should refrain from meddling in matters of policy, or appointments, or from trying to impose their views in questions of interpretation of the law on the plea that their thoughts are the ones Congress desired to convey when, as a matter of fact, Congress went to particular pains not to formulate them, because a majority could not be found to agree on a common view which could be precisely expressed. Nor should the Attorney General, a member of the Cabinet, rashly be called upon to assume the rôle of Congress in determining the intent of the law. Such appeals to the Attorney General mean, in effect, that authority to use discretion in the administration of the law comes to be vested, not in the administrative body, but in the Attorney General. Unless a Board itself sees a compelling necessity for the guidance and protection to be obtained from an Attorney General's opinion, the conduct of that Board should not needlessly be interfered with by requests for the Attorney General to intervene. If the law is to be tested, the proper arena in which to settle the dispute would be a non-partisan court of justice.

The fullest recognition should ungrudgingly be given to the "framers of the Act" for their positive as well as their negative contributions. Yet, that must not blind us to the fact that their record as regards both knowledge and performance neither compels nor justifies others in places of responsibility to concede to them a position of unchallenged superiority with regard to the interpretation of the Act or the direction of the Federal Reserve System's policies. Much rather does it follow from the facts adduced herein that it is an imperative duty of members of both parties and both Houses to inform themselves thoroughly with respect to the history of the Reserve System, its present status, and the problems of its future. This is all the more necessary, because under the auspices of the "writers of the Act" recommendations and schemes have been launched in the past which, if adopted, would have endangered or impaired the very safety of the Reserve System. One need only recall that Senator Owen, during the Great War, urged an elaborate plan to involve the Reserve System in schemes to regulate and stabilize foreign exchanges; and that Dr. Willis, in the days when depreciation of foreign currencies had only begun, registered his disapproval and regret that the Reserve System did not boldly enter the field of foreign exchange. Nor may the menace of unsound proposals from such quarters be lightly considered as a thing of the past. Only quite recently (February 25th, 1928) the *Journal of Commerce*, of which Dr. Willis is the editor-in-chief, spoke as follows:

> There are many elements in the Federal Reserve Act as it now stands on our statute books which either have been grossly violated—knowingly in some cases—or have been ignored, or have been held in abeyance.
>
> . . . There is great need for reappraisement of what we have done, what we have tried to do, and what we have failed to accomplish in our central banking field.

What the author of this editorial may have had in mind, one

can only surmise; but it may be well to remember that, in his writings and teachings, Dr. Willis has consistently condemned the modifications of the Act that enabled the Reserve System to gain the great gold strength it enjoys to-day. It still remains for him to assure us that he has given up the hope of seeing this great gold strength once more disrupted, and the law amended so as to force a return to his original plan of scattered and immobilized gold reserves and a shackled Federal reserve circulation. In addition, in spite of the staggering losses sustained by the foreign branches of some of our banks, he has continued to proclaim it to be the function and duty of reserve banks to employ the reserve funds of the member banks in pioneer work in foreign countries by having the reserve banks open foreign branches of their own (for which far-reaching departure the Act does not contain a clear and specific provision); and he further advocates that the reserve banks —which banks were introduced by Senator Owen as "banks for the banks, not expected to deal directly with the public" and of which Glass says that nobody thought of them as "central banks in the European sense transacting business with the public" (see page 411 of this volume)—be thrown open to the hazards of political loans and subjected to commercial risks by being compelled to engage in direct dealings with the public.[1] One shudders to think of the consequences if any one of these recommendations had been, or ever should be, followed in our country.

There are large problems and grave times ahead of the Reserve System. The larger these national and international problems of the country grow, the greater will be the temptation to force upon the System the responsibility of coping with tasks extraneous to its proper functions and plainly beyond its capacity. Experiments of this character would sap the System's strength, and expose it to the dissatisfaction and attacks of persons disappointed by its failure to accomplish

[1] Willis, *The Federal Reserve System*, p. 1037 and pages 1517–1518.

the impossible. Worst of all, the widening of the System's radius of activity, or the mere belief in its power to do the extraordinary things which visionaries or demagogues would force it to attempt, would strengthen the tendency to tighten the grip of political control over a System possessed of such real or imaginary powers. True friends of the System will bend their efforts towards keeping it as pure and simple as possible and having it remain unencumbered with functions and duties foreign to its essential purpose and likely to lead it upon dangerous ground. When the time comes to revise the Federal Reserve Act, those on whom the responsibility will rest should be fully equipped for the serious task of safeguarding the broad, well-recognized principles underlying the organization and operation of central banking systems, so that our great banking law may be freed and kept free from dangerous vagaries urged in the name of the "spirit of the Act," or in the name of any other spirit.

ADDENDUM II

THE STOCK EXCHANGE CRISIS OF 1929

REVIEWING the Federal Reserve System's record from the second half of 1927 to October–November of 1929, the period of the phenomenal rise and the catastrophic collapse of the structure of brokers' loans and prices of shares on the New York Stock Exchange, future historians are likely to point to two outstanding facts:

One, the impressive demonstration of the System's structural strength and,

Two, the inadequacy of its form of administration.

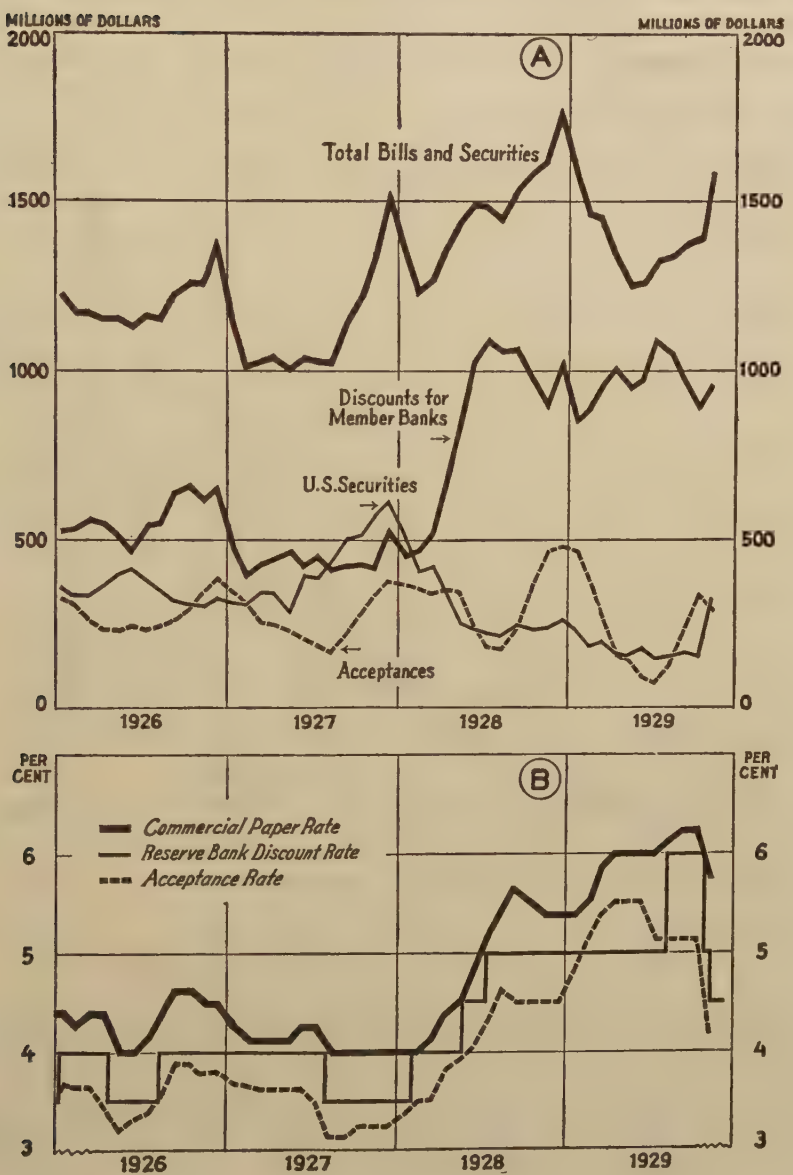
Unlike the panic of 1907, the convulsion of 1929 did not shake the people's confidence in our banking and currency system. Indeed, where in 1907 the stock exchanges were closed and stock-exchange loans became frozen, where hoarding brought gold to a premium and bank payments were suspended, New York banks in October, 1929, boldly took over some two billion dollars in loans made by out-of-town banks and "other" lenders, domestic and foreign, who had persisted in piling their funds upon the New York Stock Exchange and now had become frightened. It was due to the courageous action of a group of New York banks and of able leaders that the stock-exchange panic was ultimately brought to a halt. But the desperate fight to avert a further spread of the disaster could never have been hazarded and won had it not been for the country's unbounded confidence in the unequalled strength of the Federal Reserve System and the availability of its vast resources to the country's banks. In the face of a sudden and unparalleled shrinkage of stock-exchange values, cutting in half the brokers' loan structure of over eight billion dollars

within the short span of a few weeks,[1] bank credit remained unshaken, because it rested on the rock foundation of the Federal Reserve System. Yet, while the fire fighters ultimately managed to check the conflagration, they did not succeed in their efforts until appalling losses of property (and lives) had been suffered throughout the country. Why was it necessary, the historian will ask, for our financial authorities to stand by so long while unheard-of quantities of inflammable material were massed in an unsafe structure, and while cool observers had been warning the public of the threatening, indeed, inevitable catastrophe? That is the only phase of the question which interests us and which we wish to explore here, not with the object of praising or blaming individuals, but for the purpose of ascertaining how far the present form of administration of the Federal Reserve System and its background may be held to have been responsible for its inability to forestall so disastrous a disturbance.

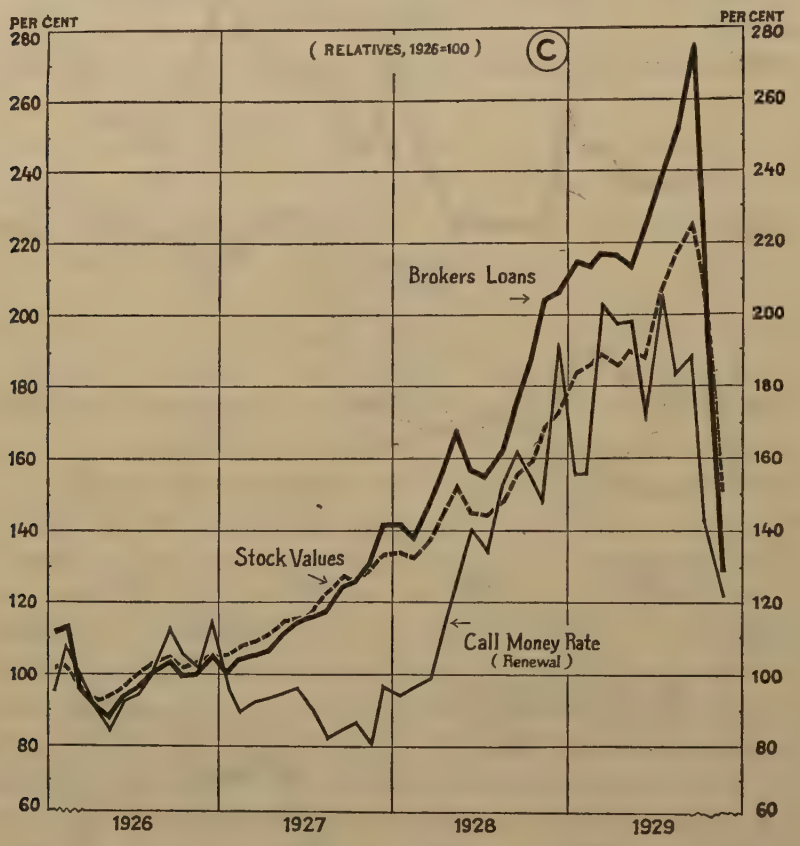
It is important to examine the evidence before attempting to judge the case, and in order to enable the reader to grasp the picture, at least in its rough outlines, some graphs have been prepared, which are here submitted for his examination.

It will be remembered that in the second half of 1927, under a daring, but carefully devised, plan, the Federal Reserve System, by reducing its discount rates to 3½ per cent and by purchasing government securities on a large scale, had embarked upon a policy of easing money in the United States with a view to aiding European countries, particularly Great Britain, in their efforts to establish or reëstablish their gold standards. This plan was entirely justified, not only as a duty towards our neighbors, but as a matter of self-interest—provided the System was prepared boldly to reverse this policy

[1] According to calculations of the New York Stock Exchange the aggregate value of securities listed on the Exchange declined between the end of September and the end of November from 87,074 to 63,589 million dollars, or 27 per cent, while the amount of brokers' loans declined during the same period from 8,549 to 4,016 million dollars, or 53 per cent.


MILLIONS OF DOLLARS
MILLIONS OF DOLLARS
2000
1500
1000
500
0
A
Total Bills and Securities
Discounts for Member Banks
U.S.Securities
Acceptances
1926
1927
1928
1929
PER CENT
PER CENT
B
Commercial Paper Rate
Reserve Bank Discount Rate
Acceptance Rate
6
5
4
3

as soon as it might become evident that excessive ease of money was exercising an inflationary effect, or that it was over-stimulating speculation. Unmistakable symptoms of such adverse effects became evident at the end of 1927. As a



consequence the Federal Reserve System did reverse its policy, and in the first months of 1928 began to resell its holdings of government bonds recently acquired. Unfortunately, however, this policy was not carried through with sufficient vigor and persistency, largely because of the fear on the part of representatives of industry and trade that further sales and the resultant hardening of money rates might "hurt business."

From then on, until the final collapse occurred, the charts record with brief interruptions a continuous rise in the prices of stocks and an unprecedented growth in stock-exchange loans.[1]

The Federal Reserve System's policy in the two years under review may be characterized as the resultant of two contending motives: on the one hand, the desire to see the orgy of speculation brought to a close, and on the other, the fear of coming to close grips with it, lest "business be hurt," or the System be charged with interfering with stock-exchange activities which, it was claimed, did not by the terms of the Federal Reserve Act come under the direct supervision or control of the Federal Reserve Board. It is true that three increases of discount rates (from 3½ per cent to 4 per cent, 4½ per cent, and 5 per cent) were successively granted in 1928.[2] But these increases came hesitatingly and by mild degrees and generally *post festum* (see Chart "B"), and when they came, what little psychological effect they otherwise might have had, was frequently weakened by statements, simultaneously given out by men in high political positions, that stock-exchange loans were not unduly high, or that money would remain easy, or that business conditions were excellent and that there was no cause for apprehension. It is small wonder that in these circumstances increases in discount rates were practically without effect in dampening the exuberant spirit of unleashed

[1] Graph "A," showing total investments of all Federal reserve banks, demonstrates the inadequate liquidation of the System's holdings of United States Government bonds in January and February, 1928. It will be seen that, normally, the reserve banks hold the lowest aggregate of investments in these months, and this lowest point offers the basis, as it were, for the year's coming operations. The low point in 1928 will be found some $200,000,000 above the low point in 1927.

From chart "C" it will readily be seen how the lines indicating the rise in stock-exchange loans and in stock prices find their starting point at the end of 1927.

[2] It will be remembered that the Bank of England as a rule advances its rate by a full per cent.

speculation, which had gripped all classes in all parts of the country.

After discount rates had been raised to 5 per cent in July, 1928, the Board until August 9th, 1929 refused to approve any further increases requested by Federal reserve banks. It is true that on February 7th, 1929 the Board published a strong statement in which it warned the people of the dangers involved in the undue absorption of the country's credit supply in speculative uses and in which it indicated its determination to suppress any such excessive absorption of credit, a goal which it thought it could attain without a further increase in discount rates. This warning had only a temporary effect. Stock-exchange prices soon continued their upward trend and the brokers' loan structure went on rising from week to week. The Federal Reserve System in this period showed the most anomalous rate structure ever devised by any powerful central bank (see chart "B").[1]

On April 2nd, 1929, the Board issued a second warning which, like its first statement, had only a temporary effect in arresting the upward movement of stock-exchange loans.

[1] When prime commercial 90-day paper was selling at 6 per cent to 6¼ per cent; when the government borrowed for short periods at 5⅛ per cent tax-free (being the equivalent of about 5.85 per cent as compared with taxable commercial paper); when rates for call money varied from 7 to 25 per cent and those for time money from 7½ to 9½ per cent; and, finally, when bankers' acceptances were selling at 5½ per cent, a bank rate of 5 per cent was beyond all understanding. It meant that the reserve banks were buying in the open market the finest quality of paper at a rate of 5½ per cent and above, *while paper of lower quality* handed in by the same seller at the rediscount window would have to be taken by the reserve banks at 5 per cent, indeed, in some districts even at 4½ per cent! It was not surprising that in the face of the high price which money commanded all over the country more than a billion dollars of paper was rediscounted with the reserve banks at these tempting rates.

An examination of the chart showing the movements of the aggregate investments of the Federal reserve banks indicates that the total rediscounts hovered around the 500 million dollar line in 1925, 1926, and 1927, while from the middle of 1928 until the collapse of October, 1929, they are found around the one billion dollar line.

These loans, from the middle of 1927, had then risen by approximately 2½ billion dollars. On May 21st, 1929, the Advisory Council submitted to the Board a definite recommendation to increase the prevailing discount rates to 6 per cent. The Board published this resolution (quite against its custom), but remained adamant in its opposition to the demand of Federal reserve banks to move their discount rate above 5 per cent.

In May, 1929, several bad breaks occurred in the stock market. On May 27th, particularly, the stock exchange suffered a severe sinking spell which, for a while, created grave apprehension that frantic liquidation might degenerate into a panicky stampede. This danger was arrested by the prompt intercession of New York banks. This was wise in so far as it was obviously desirable to keep the selling movement within the bounds of orderly liquidation. If, however, this support had been given less ostentatiously, and if, instead of giving new courage to the "bulls," a concerted effort had then been made to encourage a quiet but persistent liquidation, the country's interests would have been far better served. As it was, the market had shown unmistakable symptoms of its intrinsic weakness; it had demonstrated to experienced observers that stocks had advanced far beyond a price level at which they might readily be absorbed by conservative investors, and that any concerted attempt to unload some 10 billion dollars in securities carried by brokers' and bank loans might precipitate violent declines with catastrophic consequences. Nevertheless, on this shaky foundation the tottering brokers' loan structure was permitted to rise by another billion dollars, while numberless investment trusts—daring in plan and scope and operating to produce a further pyramiding of prices—were floated almost from day to day and stock quotations soared to new fantastic levels.

The Board, in these fateful months, sat still. Finally, on August 9th, 1929—in the author's opinion at least half a year, if not a year, too late—it permitted the New York Reserve

Bank to raise its rate to 6 per cent, which raise was accompanied, however, by a simultaneous decrease in the Federal Reserve System's open market rates. Moreover, the 5 per cent rate remained in force in all other districts. This belated increase, which at best brought the New York rediscount rate into a more reasonable relation to actually prevailing market rates, exercised only temporarily a sobering effect upon the frenzied minds of those wedded to the gospel of investing and speculating in inflated stocks. Spokesmen for that school of thought by that time had become openly defiant. Financial leaders, prominent economists, and men in high political positions had become convinced that a "new era" had arrived, that hopes and expectations of future accomplishments were to be accepted as the test in determining stock values, rather than actual earnings and records of the past, and that those who claimed that some twelve billion dollars in undigested securities constituted an element of danger did not realize that this gigantic amount represented only a safe and reasonable percentage of the new (inflated) value of our securities. The disciples of the gospel of the "new era" were frankly resentful of the "meddling of eight men at Washington" and saw in the Federal Reserve Board's power of interference a danger which a change in the law, if necessary, should eliminate.

Views directly opposite were held by the conservatives among bankers, business men, and government officials. They sided with the Board's views—bravely expressed in the beginning, but now strangely inarticulate—that the towering loan pyramid on the stock exchange constituted an element of grave danger; but they were disheartened and alarmed at the Board's apparent unwillingness or inability to bring this ominous run-away movement to a halt.

The Board thus found itself subjected to a cross fire from two opposing camps, one blaming it for meddling too much, the other for not meddling enough. To cool observers it was

clear beyond doubt, first, that the Board's attempt to bring about a loan contraction without adequately increasing rediscount rates had proved an impracticable and wasteful experiment, and second, that unless a more effective course were pursued the country was headed for a most serious catastrophe.

What my own thoughts and apprehensions were in the matter I laid down in a statement published March 7th, 1929, a reprint of which will be found as Appendix Thirty-Seven. This statement is referred to, not for the doubtful satisfaction of seeing one's views vindicated, but in order to show that it was entirely possible, indeed easy enough, at that time to foresee what inevitably had to occur unless we promptly mended our ways.

In the spring of 1929, it had become apparent that increases in discount rates alone—unless undertaken with a vigor which the Board, unfortunately, could not be expected to display—would not prove strong enough weapons with which to conquer an enemy, who by that time had lost all respect for the authority and power of the Board. Yet, it was still possible to bring the mad fling to a halt before the worst calamity had occurred. What after all was to be accomplished? The Board (and its backers) desired to arrest a further growth of the aggregate of "brokers' loans." The Board had attempted to bring this about by discouraging member banks from borrowing from the Federal reserve banks for the purpose of investing the proceeds in stock-exchange loans. But the New York banks were neither the heaviest borrowers of funds from the Federal reserve banks, nor were they the heaviest lenders, for their own account, of stock-exchange funds. The bulk, as is well known, came from out-of-town banks (able to borrow from their Federal reserve banks at 5 per cent or even 4½ per cent), from corporations, and from foreign lenders. This made it well-nigh impossible—as long as the low rate policy was continued—to attack the problem through the lenders of whom so important a group was entirely beyond

the reach of the Federal Reserve System. It would have been possible, however, to control the situation if means could have been found to secure the coöperation of the borrowers. If the New York Clearing House Committee, acting under the auspices of the Federal Reserve System, had sent for a Stock Exchange Committee and, after explaining to them the dangers and needs of the situation, had invited them to ask every stock exchange firm within a given time to reduce its borrowings—whatever they might be—by a given small percentage of their aggregate loans, the top of the market would have been reached then and there, and liquidation would gradually have set in (if needs be demands for further reductions might have been made at a later stage). Nobody could have resisted the argument that unless the stock exchange reduced its loans by its own volition, the pressure of increased rediscount rates would ultimately have to be applied with subsequent increases in the discount rates of leading central banks in Europe. Higher money rates abroad, with distressing consequences for industry and trade in the countries affected, would result from such a course. Europe, it was clear, could not much longer stand the cruel perversion of our banking policy adopted in 1927 which, originally designed to encourage a free flow of long and short-term credit from the United States to foreign countries, was now draining the Old World of its working capital and its gold. Such conditions finally would have to lead to a slowing down of our business, which in turn would bring about a fall in the prices of our shares on the stock exchanges and, as a concomitant, a corresponding shrinkage of stock-exchange loans. In other words, world-wide distress and a slowing down of our own business would have to be conjured up in order to prevent our stock exchanges from draining the credit reservoirs on both sides of the Atlantic.[1] It could have been made clear that a better process

[1] How completely world money markets had fallen under the control of our speculators is impressively shown by the fact that within six weeks after

would have been to avoid this circuitous and wasteful road and to aim straight for a contraction of loans which would carry with it an orderly liquidation on the stock exchanges without drastically affecting business in general either here or abroad. If the Federal Reserve System and the Clearing House banks had definitely agreed on the adoption of such a plan, the stock exchanges would have been forced to fall in line; for, no matter how large a volume of funds stock-exchange firms were receiving from "others," they would have realized that, in the final analysis, they were depending upon the strength and good will of the New York banks. A course as above described is not here discussed as an afterthought. A procedure along these lines was definitely urged in the first days of April, 1929. But while everybody seemed to agree on the desirability and practicability of such a plan, it proved impossible to carry it into effect. The Reserve System feared to expose itself to the charge of having gone beyond its lawful field of activity by dealing, even indirectly, with the stock exchanges, and the Clearing House banks, loath in any case to undertake so unpopular a step, did not see their way clear to hazard it at all as long as Federal reserve discount rates were not increased to 6 per cent. So long as the Federal reserve rates stood at 5 per cent, and below, they feared, and justly so, that enforced reductions of loans in brokers' offices would only result in driving the customers into

the October crash on the New York Stock Exchange fifteen reductions of official discount rates were undertaken by eleven European central banks, viz. Bank of England, from 6½ to 6 per cent (October 31), to 5½ per cent (November 21), and to 5 per cent (December 12); Reichsbank, from 7½ to 7 per cent (November 2); Bank of Netherlands, from 5½ to 5 per cent (November 1) and to 4½ per cent (November 15); Bank of Belgium, from 5 to 4½ per cent (November 13); Swedish Riksbank, from 5½ to 5 per cent (December 13); Norges Bank, from 6 to 5½ per cent (November 21); Austrian National Bank, from 8 to 7½ per cent (December 9); Hungarian National Bank from 8 to 7½ per cent (November 4); Bank of Danzig, from 7 to 6½ per cent (November 2) and to 6 per cent (November 21); Bank of Poland from 9 to 8½ per cent (November 14); Bank of Rumania, from 9½ to 9 per cent (November 25).

the banks and thus create a highly embarrassing, indeed an impossible, situation.

With the Board unwilling at that time to permit the increase, to which four months later it agreed, it is not surprising that the proposal fell through. A glance at the graphs will convincingly demonstrate that, while stock prices and the pyramid of brokers' loans had already reached dizzy heights in the first quarter of 1929, they still were much lower than in the fall of that year. One may readily perceive how much smaller the ultimate shrinkage and losses would have been if liquidation had been brought about at that time.

This brief sketch of the conditions which led to the stock-exchange panic of 1929 and of the Federal Reserve System's inability to forestall the final disaster or, at least, to prevent it from assuming its overwhelming magnitude, has been prepared for the sole purpose of illustrating once more the imperative need for the adoption of some such measures as have been outlined in Chapter XII for the strengthening of the System's methods of administration. There is no desire to fasten blame on any individual who took part in fashioning the System's policies in this trying period. No doubt, everybody concerned acted to the best of his knowledge and ability, and the keener his realization of the gravity of his responsibilities, the greater, of course, was the persistency with which he held to his own views. The fact remains, however, that in the face of a most critical situation—possibly the gravest with which the Federal Reserve System has ever been confronted—we find a Federal Reserve Board widely divided within itself and unable to agree upon a definite and effective plan. We find this Board, as rumor has it, at variance with leading Federal reserve banks and, against the advice of the Advisory Council, blocking timely rate increases urged by the Federal reserve banks most concerned. It is easy to see how differently a composite Board, as recommended in Chapter XII, would have acted. Instead of deadlocks, there would have been unity of action,

and whatever such action might have been it would have commanded confidence and respect. The writer is profoundly convinced that with a different constitution of the Board, the ominous stock-exchange debauch would have been arrested long before it reached its colossal dimensions.

In fairness it must be admitted, however, that any Board —no matter what its constitution—would have found it a Herculean, if not an impossible, task to perform its functions wisely and efficiently in circumstances such as surround it at present. In a country whose idol is prosperity, any attempt to tamper with conditions in which easy profits are made and people are happy, is strongly resented. It is a desperately unpopular undertaking to dare to sound a discordant note of warning in an atmosphere of cheer, even though one might be able to forecast with certainty that the ice, on which the mad dance was going on, was bound to break. Even if one succeeded in driving the frolicking crowd ashore before the ice cracked, there would have been protests that the cover was strong enough and that no disaster would have occurred if only the situation had been left alone.

The Board, much to its credit, had the courage to warn the country, but it stayed its hand when it should have driven the people ashore before the ice broke. It hesitated to sacrifice what appeared to the country to be actual prosperity to what might have seemed to the people a problematical disaster. Hence the Board's unwillingness to increase rates beyond 5 per cent; its unwillingness "to hurt business," even though generally prevailing rates had long reached, or surpassed, the level of a 6 per cent bank rate, and even though it was plainly to be foreseen that, if rates were not increased, business in the end might have to suffer a severe setback, while with quick and determined increases, incisive enough to bring about liquidation, the period of high money rates would probably be so brief that business might hardly be affected by it. It was a trying position for the Board, one

which called for clear vision, cool heads, and a courageous disregard of all personal and political considerations. But while facing these difficulties the Board found itself harassed by a cross fire from members of Congress. As in the Chicago case, discussed in the preceding chapter, the views pressed upon the Board by these men were diametrically opposed to one another. Each side, however, threatened "legislation" in case its views were disregarded.

The chairman of the House Banking and Currency Committee expressed himself as out of sympathy with the Board's interference with stock-exchange loans, and seemed to advocate the admission to the Federal reserve bank portfolios of paper liberally secured by stock-exchange collateral, while ex-Senator Owen, one of the "framers of the Act," appeared as counsel in a suit to restrain the Federal Reserve Bank of New York from its allegedly "illegal conduct"—"in restricting the supply of credit available for investment purposes" and "from arbitrarily and unreasonably raising the discount rate"—"for the purpose and with the effect of raising interest rates generally and call-money rates on the New York Stock Exchange in particular." Senator Glass, on the other hand, reproached the Board for not having acted energetically enough in fighting the stock-exchange debauch, but, unfortunately, went to the extreme of branding as unlawful the rediscount with Federal reserve banks of eligible paper where the proceeds, after having become intermingled with the funds of the borrowing member banks, were invested in stock-exchange loans.[1]

[1] In the latter contention it is impossible to follow Senator Glass. The Federal reserve banks must closely scrutinize the paper a member bank offers for rediscount and must not accept any bills except such as have proved eligible. Once it has rediscounted the bills, the member bank must be left free, however, to keep its proceeds as a balance with the Federal reserve bank, to send them abroad, or to do anything with them that the member bank's charter and the laws under which it operates, permit. If the New York banks, in November, 1929, had not acted on this assumption they could never have

Is it to be wondered at that, thus exposed to attacks on both flanks, the Federal Reserve System found safety in inaction rather than in action? But, looking backward in the light of recent experience, would not those who violently protested against the exertion of any "paternalistic influence"—which they perceived in the Federal Reserve Board's attempt to restrain speculation—freely admit to-day that they were mistaken? President Hoover has received well-deserved commendation for the masterful strategy with which he united industries and railroads, labor and agriculture, Federal, State, and municipal governments in a common effort to counteract the adverse consequences which the stock-exchange panic of 1929 might visit upon the country. Does it not seem absurd that paternalistic guidance should be gratefully accepted in the face of the actual occurrence of a grave calamity, but that it should be resented when connected with an effort to forestall it? Is it not childish that we should be willing to fight an epidemic after it has spread and taken its heavy toll, but should be unwilling to localize the disease before it had gotten beyond our control? Does not the recent disaster teach us that, while the transactions which Federal reserve banks are permitted to engage in must remain strictly circumscribed as at present, it does not follow that the System's field of influence is restricted within the narrow circle of these transactions? A petty Reserve System, that is to be no more than a fire engine or an ambulance, cannot give the country the service and protection, nor the prestige, to which it is entitled. A Federal Reserve System worthy of its name, while "accommodating commerce and business," must at the same time seek its highest aim in preserving for the United

saved the situation by taking over the out-of-town-bank and other loans when the crash came. If they had hesitated to do so, then, indeed, conditions approaching those of 1907 might have arisen. This does not mean, however, that a Federal reserve bank should not be free to act according to its own discretion if a member bank were to use Federal reserve bank credit excessively, or too continuously, or in a manner harmful to the country's interests.

States conditions of stability in which commerce and business may thrive. This does not mean absolute price or business stability. Fluctuations within fairly normal swings may be necessary and healthy, and any attempt to compel the Federal Reserve System uniformly to offset them would be dangerous and Utopian. But whenever extreme economic or financial developments threaten to unbalance the even course of banking or business, including agriculture—the Federal Reserve System must be left free and untrammelled to exercise its influence in forestalling such disturbances and to back its efforts with the weapons with which the Act has endowed it. If this is the position that Congress desires the Federal Reserve System to occupy, it may be worth while to consider the advisability of amplifying the wording of the sub-title of the Federal Reserve Act [1] so that in future emergencies there may be no doubt as to the meaning of the Act with regard to this larger conception of the Federal Reserve System's aims and functions.

It appeared opportune to add this brief analysis of the history of the stock-exchange panic of 1929 on account of the overwhelming proof it offers, first, of the need of giving to the Federal Reserve System a form of administration that will weld the Board and the reserve banks together instead of splitting them apart and matching them against one another to the point of deadlock and second, of the necessity of securing from Congress a clear and definite interpretation with regard to essential functions of the System so that a Board, composed of government appointees and representatives of the Federal reserve banks (as recommended in Chapter XII), may devote itself to its difficult task without being needlessly harassed

[1] The sub-title of the Federal Reserve Act reads as follows:

"An Act to provide for the establishment of Federal reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes."

by the conflicting views and interpretations of members of Congress, of business men and bankers, or members of the learned professions. The history of the stock-exchange panic of 1929 lends added emphasis to the conclusions presented in previous chapters, viz: That we need an expert and independent administration uniting, instead of separating, the Board and the reserve banks—a Board whose acts, prompt and definite, would be accepted by all as the authoritative conclusions of the common counsel of the best minds which government and business can produce—and that, having secured such a Board, we should see to it that it be exposed to as little interference from politics and business as is humanly possible.

ADDENDUM III

SUGGESTED CHANGE FOR CONSTITUTION OF FEDERAL RESERVE BANKS' DIRECTORATES

THE following plan is submitted with a view to improving the methods of electing the directorates of reserve banks and branches. The same plan was proposed by me during the formulation of the Aldrich Bill and the suggestion was repeated while the Federal Reserve Act was being written.

It is proposed that the election begin at the sub-districts into which the Federal reserve districts containing one or more branches are divided. What is envisaged in this proposal may best be shown by taking the Reserve Bank of San Francisco as an example. Each of the sub-districts, including in this case San Francisco, Los Angeles, Portland, Spokane, Seattle, and Salt Lake City, would elect its own board of directors, following the same methods as those which are observed to-day in electing the directorates of the twelve regional banks. Each sub-district, as well as the area served by the head office, would thus elect three Class A directors and three Class B directors, while the Federal Reserve Board would appoint three Class C directors. Of the Class C directors, one would be designated as chairman. Each sub-district would then delegate two directors, one from Class A and one from Class B, to serve as directors of the Federal Reserve Bank of San Francisco. But in order to avoid making some of the regional directorates too large, it might be provided in districts, where the number of sub-districts exceeds a given number, that the branch territory should select only one director for the district board, with a second member delegated to act, upon occasion, as his substitute. These delegates would thus

constitute two-thirds of the directors of the Federal Reserve Bank of San Francisco, and the remaining one-third would be appointed as Class C directors by the Federal Reserve Board. In this manner, each branch would have a board competent to administer its own local affairs, while for questions affecting the district as a whole there would be a composite board truly representative of the entire district. In the interim between full board meetings, an executive committee would be in charge.

At present, there is in some districts a directorate which is almost entirely representative of the reserve bank city and its immediate surroundings, a directorate on which, therefore, the sub-districts are insufficiently represented. In other Federal reserve districts, a contrary condition prevails and we find reserve banks whose boards of directors represent overwhelmingly the surrounding sub-districts, with the result that, in dealing with its local affairs, the Federal reserve bank suffers from a lack of directors representing its own immediate locality.

If the plan here proposed were followed, each sub-district, including the head office, would have a local board to oversee the local business, while, as already stated, for questions affecting the entire district there would be a board upon which all branches and the head office would be represented. The plan would have the additional advantage of precluding any possibility of undue predominance on the part of any city or section in the composition of the directorates of the Federal reserve banks. It may also be pointed out that if, under the plan proposed in Chapter XII, the twelve Federal reserve banks were permitted to elect four delegates to the Federal Reserve Board, each delegate so elected by the combined action of the directorates of three reserve banks, could safely be expected to be a man possessing the highest qualifications, both as to character and knowledge.

ADDENDUM IV

SELECTED SECTIONS OF THE FEDERAL RESERVE ACT SHOWING THE ALTERATIONS EFFECTED BY AMENDMENTS DURING THE PERIOD AUGUST 15, 1914, TO APRIL 5, 1918, INCLUSIVE

Italics indicate new matter inserted by amendments and canceled words indicate old matter stricken out. Dates of the amendments are given in the margin.

State Banks as Members

SECTION NINE

June 21, 1917 Any bank incorporated by special law of any State, or organized under the general laws of any State or of the United States, *desiring to become a member of the Federal reserve system*, may make application to the ~~reserve bank organization committee, pending organization, and thereafter to the~~ Federal Reserve Board, *under such rules and regulations as it may prescribe*, for the right to subscribe to the stock of the Federal reserve bank organized ~~or to be organized~~ within the ~~Federal reserve~~ district ~~where the applicant~~ *in which the applying bank* is located. *Such application shall be for the same amount of stock that the applying bank would be required to subscribe to as a national bank.* The ~~organization committee or the~~ Federal Reserve Board, ~~under~~ *subject to* such ~~rules and regulations~~ *conditions* as it may prescribe, ~~subject to the provisions of this section,~~ may permit the

applying bank to become a stockholder ~~in the~~ *of such* Federal reserve bank. ~~of the district in which the applying bank is located,~~

June 21, 1917 *In acting upon such applications the Federal Reserve Board shall consider the financial condition of the applying bank, the general character of its management, and whether or not the corporate powers exercised are consistent with the purposes of this Act.*

June 21, 1917 Whenever ~~the organization committee or~~ the Federal Reserve Board shall permit the applying bank to become a stockholder in the Federal reserve bank of the district, *its* stock *subscription* shall be ~~issued and paid for under the rules and regulations in this Act provided for national banks which become stockholders in Federal reserve banks,~~ *payable on call of the Federal Reserve Board, and stock issued to it shall be held subject to the provisions of this Act.*

June 21, 1917 ~~Any bank becoming a member of a Federal reserve bank~~ *All banks admitted to membership* under ~~the provisions~~ *authority* of this section shall, ~~in addition to the regulations and restrictions hereinbefore provided,~~ be required *to comply with the reserve and capital requirements of this Act and* to conform to ~~the~~ *those* provisions of law imposed on ~~the~~ national banks ~~respecting the limitation of liability which may be incurred by any person, firm, or corporation to such banks, the~~ *which* prohibit~~ion against making~~ *such banks from lending on or* purchas~~ing of or loans on~~ *their own* stock, ~~of such banks, and~~ *which relate to* the withdrawal or impairment of *their* capital, *stock and which relate to* ~~or~~ the payment of unearned dividends, ~~and to such rules and~~

~~regulations as the Federal Reserve Board may, in pursuance thereof, prescribe.~~ Such banks, and the officers, agents, and employees thereof, shall also be subject to the provisions of and to the penalties prescribed by section~~s~~, ~~fifty-one hundred and ninety-eight, fifty-two hundred, fifty-two hundred and one, and fifty-two hundred and eight, and~~ fifty-two hundred and nine of the Revised Statutes, ~~The member banks~~, *and* shall ~~also~~ be required to make reports of ~~the~~ condition and of the payments of dividends to the ~~Comptroller~~, *Federal reserve bank of which they become a member. Not less than three of such reports shall be made annually on call of the Federal reserve bank on dates to be fixed by the Federal Reserve Board.* ~~as provided in sections fifty-two hundred and eleven and fifty-two hundred and twelve of the Revised Statutes, and shall be subject to the penalties prescribed by section fifty-two hundred and thirteen for the~~ Failure to make such reports *within ten days after the date they are called for shall subject the offending bank to a penalty of $100 a day for each day that it fails to transmit such report; such penalty to be collected by the Federal reserve bank by suit or otherwise.*

June 21, 1917 *As a condition of membership such banks shall likewise be subject to examinations made by direction of the Federal Reserve Board or of the Federal reserve bank by examiners selected or approved by the Federal Reserve Board.*

June 21, 1917 *Whenever the directors of the Federal reserve bank shall approve the examinations made by the State authorities, such examinations and the reports thereof may be accepted in lieu of examina-*

tions made by examiners selected or approved by the Federal Reserve Board: Provided, however, That when it deems it necessary the board may order special examinations by examiners of its own selection and shall in all cases approve the form of the report. The expenses of all examinations, other than those made by State authorities, shall be assessed against and paid by the banks examined.

June 21, 1917 If at any time it shall appear to the Federal Reserve Board that a member bank has failed to comply with the provisions of this section or the regulations of the Federal Reserve Board, *made pursuant thereto*, it shall be within the power of the ~~said~~ board, after hearing, to require such bank to surrender its stock in the Federal reserve bank, *and to forfeit all rights and privileges of membership.* ~~upon such surrender (the Federal reserve bank)[1] shall pay the (cash paid subscriptions) to the said stock (with interest at the rate of one-half of one per centum per month), computed (from the last dividend, if earned), not (to exceed the book value) thereof, less any liability to said Federal reserve bank, except the subscription liability not previously called, which shall be canceled, and said Federal reserve bank shall, upon notice from the said Federal Reserve Board, be required to suspend said bank from further privileges of membership and shall within thirty days of such notice cancel and retire its stock and make payment therefor in the manner herein provided.~~ The Federal Reserve Board may restore membership upon due proof of compliance with the conditions imposed by this section.

June 21, 1917 *Any State bank or trust company desiring to*

[1] Matter in parentheses forms part of new paragraphs.

withdraw from membership in a Federal reserve bank may do so, after six months' written notice shall have been filed with the Federal Reserve Board, upon the surrender and cancellation of all of its holdings of capital stock in the Federal reserve bank: Provided, however, That no Federal reserve bank shall, except under express authority of the Federal Reserve Board, cancel within the same calendar year more than twenty-five per centum of its capital stock for the purpose of effecting voluntary withdrawals during that year. All such applications shall be dealt with in the order in which they are filed with the board. Whenever a member bank shall surrender *its stock holdings in a* Federal reserve bank, *or shall be ordered to do so by the Federal Reserve Board, under authority of law, all of its rights and privileges as a member bank shall thereupon cease and determine, and after due provision has been made for any indebtedness due or to become due to the Federal reserve bank it shall be entitled to a refund of its* cash-paid subscription with interest at the rate of one-half of one per centum per month from *date of* last dividend, if earned, *the amount refunded in no event* to exceed the book value *of the stock at that time, and shall likewise be entitled to repayment of deposits and of any other balance due from the Federal reserve bank.*

June 21, 1917

~~The organization committee or the Federal Reserve Board shall establish by-laws for the general government of its conduct in acting upon applications made by the State banks and banking associations and trust companies for stock ownership in Federal reserve banks. Such by-laws shall require applying banks not organized~~

~~under Federal law to comply with the reserve and capital requirements and to submit to the examination and regulations prescribed by the organization committee or by the Federal Reserve Board.~~ No applying bank shall be admitted to membership in a Federal reserve bank unless it possesses a paid-up, unimpaired capital sufficient to entitle it to become a national banking association in the place where it is situated under the provisions of the national bank Act.

June 21, 1917

Banks becoming members of the Federal Reserve System under authority of this section shall be subject to the provisions of this section and to those of this Act which relate specifically to member banks, but shall not be subject to examination under the provisions of the first two paragraphs of section fifty-two hundred and forty of the Revised Statutes as amended by section twenty-one of this Act. Subject to the provisions of this Act and to the regulations of the board made pursuant thereto, any bank becoming a member of the Federal Reserve System shall retain its full charter and statutory rights as a State bank or trust company, and may continue to exercise all corporate powers granted it by the State in which it was created, and shall be entitled to all privileges of member banks: Provided, however, That no Federal reserve bank shall be permitted to discount for any State bank or trust company notes, drafts, or bills of exchange of any one borrower who is liable for borrowed money to such State bank or trust company in an amount greater than ten per centum of the capital and surplus of such State bank or trust company, but the discount of bills of exchange drawn against actually existing value and the dis-

count of commercial or business paper actually owned by the person negotiating the same shall not be considered as borrowed money within the meaning of this section. The Federal reserve bank, as a condition of the discount of notes, drafts, and bills of exchange for such State bank or trust company, shall require a certificate or guaranty to the effect that the borrower is not liable to such bank in excess of the amount provided by this section, and will not be permitted to become liable in excess of this amount while such notes, drafts, or bills of exchange are under discount with the Federal reserve bank.

June 21, 1917 *It shall be unlawful for any officer, clerk, or agent of any bank admitted to membership under authority of this section to certify any check drawn upon such bank unless the person or company drawing the check has on deposit therewith at the time such check is certified an amount of money equal to the amount specified in such check. Any check so certified by duly authorized officers shall be a good and valid obligation against such bank, but the act of any such officer, clerk, or agent in violation of this section may subject such bank to a forfeiture of its membership in the Federal Reserve System upon hearing by the Federal Reserve Board.*

Powers of Federal Reserve Banks

Section Thirteen

Sept. 7, 1916 Any Federal reserve bank may receive from any of its member banks, and from the United States, deposits of current funds in lawful money, national-bank notes, Federal reserve notes, or

Canceled Sept. 7, 1916

checks, and drafts, ~~upon solvent member banks,~~ payable upon presentation~~,~~ *and also, for collection, maturing*

June 21, 1917

notes and

Sept. 7, 1916

bills;

or solely for *purposes of* exchange *or of collection*, may receive from other Federal reserve banks deposits of current funds in lawful money, national-bank notes, or checks ~~and drafts~~ upon ~~solvent member or~~ other Federal reserve banks, *and checks and drafts*, payable upon presentation *within its district, and maturing*

June 21, 1917

notes and

Sept. 7, 1916

bills payable within its district;

June 21, 1917

or, solely for the purposes of exchange or of collection, may receive from any nonmember bank or trust company deposits of current funds in lawful money, national-bank notes, Federal reserve notes, checks and drafts payable upon presentation, or maturing notes and bills: Provided, such nonmember bank or trust company maintains with the Federal reserve bank of its district a balance sufficient to offset the items in transit held for its account by the Federal reserve bank: Provided further, That nothing in this or any other section of this Act shall be construed as prohibiting a member or nonmember bank from making reasonable charges, to be determined and regulated by the Federal Reserve Board, but in no case to exceed 10 cents per $100 or fraction thereof, based on the total of checks and drafts presented at any one time, for collection or payment of checks and drafts and remission therefor by exchange or otherwise; but no such charges shall be made against the Federal reserve banks.

Sept. 7, 1916

Upon the indorsement of any of its member banks, ~~with~~ *which shall be deemed* a waiver of demand, notice and protest by such bank*,* *as to its own indorsement exclusively,* any Federal reserve bank may discount notes, drafts, and bills of exchange arising out of actual commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act. Nothing in this Act contained shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise from being eligible for such discount; but such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the Government of the United States. Notes, drafts, and bills admitted to discount under the terms of this paragraph must have a maturity at the time of discount of not more than ninety days*, exclusive of days of grace: Provided,* That notes, drafts, and bills drawn or issued for agricultural purposes or based on live stock and having a maturity not exceeding six months, *exclusive of days of grace,* may be discounted in an amount to be limited to a percentage of the ~~capital~~ *assets* of the Federal reserve bank, to be ascertained and fixed by the Federal Reserve Board.

Sept. 7, 1916 The aggregate of such notes, *drafts*, and bills bearing the signature or indorsement of any one *borrower, whether a* person, company, firm, or corporation, rediscounted for any one bank shall at no time exceed ten per centum of the unimpaired capital and surplus of said bank; but this restriction shall not apply to the discount of bills of exchange drawn in good faith against actually existing values.

Sept. 7, 1916 Any Federal reserve bank may discount acceptances ~~which are based on the importation or exportation of goods and~~ *of the kinds hereinafter described*, which have a maturity at the time of discount of not more than three ~~months,~~ *months' sight, exclusive of days of grace*, and *which are* indorsed by at least one member bank. ~~The amount of acceptances so discounted shall at no time exceed one-half the paid up~~

Mar. 3, 1915 ~~*and unim-*~~
Canceled ~~*paired*~~
Sept. 7, 1916 ~~capital stock and surplus of the bank for which the rediscounts are made,~~ ~~*except by authority of the Federal Reserve Board, under such general regulations as said board may prescribe, but not to exceed the capital stock and surplus of such bank.*~~

Sept. 7, 1916 Any member bank may accept drafts or bills of exchange drawn upon it ~~and~~ *having not more than six months' sight to run, exclusive of days of grace, which* grow~~ing~~ out of transactions involving the importation or exportation of goods; ~~having not more than six months sight to run;~~ ~~but~~ *or which grow out of transactions involving the domestic shipment of goods provided shipping documents conveying or securing title are attached*

at the time of acceptance; or which are secured at the time of acceptance by a warehouse receipt or other such document conveying or securing title covering readily marketable staples. No member bank shall accept, whether in a foreign or domestic transaction, for any one person, company, firm, or corporation to an amount equal at any time in the aggregate to more than ten per cent of its paid-up and unimpaired capital stock and surplus unless the bank is secured either by attached documents or by some other actual security growing out of the same transaction as the acceptance and no bank shall accept such bills to an amount equal at any time in the aggregate to more than one-

Mar. 3, 1915 half *of* its paid-up *and unimpaired* capital stock

Canceled and surplus: ~~*except by authority of the Federal*~~

Sept. 7, 1916 ~~*Reserve Board, under such general regulations as said board may prescribe, but not to exceed the capital stock and surplus of such bank, and such regulations shall apply to all banks alike regardless of the amount of capital stock and surplus.*~~

June 21, 1917 *Provided, however, That the Federal Reserve Board, under such general regulations as it may prescribe, which shall apply to all banks alike regardless of the amount of capital stock and surplus, may authorize any member bank to accept such bills to an amount not exceeding at any time in the aggregate one hundred per centum of its paid-up and unimpaired capital stock and surplus: Provided, further, That the aggregate of acceptances growing out of domestic transactions shall in no event exceed fifty per centum of such capital stock and surplus.*

Sept. 7, 1916 *Any Federal reserve bank may make advances to its member banks on their promissory notes for*

a period not exceeding fifteen days at rates to be established by such Federal reserve banks, subject to the review and determination of the Federal Reserve Board, provided such promissory notes are secured by such notes, drafts, bills of exchange, or bankers' acceptances as are eligible for rediscount or for purchase by Federal reserve banks under the provisions of this Act, or by the deposit or pledge of bonds or notes of the United States.

Section fifty-two hundred and two of the Revised Statutes of the United States is hereby amended so as to read as follows:

"Sec. 5202. No national banking association shall at any time be indebted, or in any way liable, to an amount exceeding the amount of its capital stock at such time actually paid in and remaining undiminished by losses or otherwise, except on account of demands of the nature following:

First. Notes of circulation.

Second. Moneys deposited with or collected by the association.

Third. Bills of exchange or drafts drawn against money actually on deposit to the credit of the association, or due thereto.

Fourth. Liabilities to the stockholders of the association for dividends and reserve profits.

Fifth. Liabilities incurred under the provisions of the Federal Reserve Act.

Apr. 5, 1918 *Sixth. Liabilities incurred under the provisions of the War Finance Corporation Act.*

Sept. 7, 1916 The *discount and* rediscount *and the purchase and sale* by any Federal reserve bank of any bills receivable and of domestic and foreign bills of exchange, and of acceptances authorized by

this Act, shall be subject to such restrictions, limitations, and regulations as may be imposed by the Federal Reserve Board.

Sept. 7, 1916

That in addition to the powers now vested by law in national banking associations organized under the laws of the United States any such association located and doing business in any place the population of which does not exceed five thousand inhabitants, as shown by the last preceding decennial census, may, under such rules and regulations as may be prescribed by the Comptroller of the Currency, act as the agent for any fire, life, or other insurance company authorized by the authorities of the State in which said bank is located to do business in said State, by soliciting and selling insurance and collecting premiums on policies issued by such company; and may receive for services so rendered such fees or commissions as may be agreed upon between the said association and the insurance company for which it may act as agent; and may also act as the broker or agent for others in making or procuring loans on real estate located within one hundred miles of the place in which said bank may be located, receiving for such services a reasonable fee or commission: Provided, however, That no such bank shall in any case guarantee either the principal or interest of any such loans or assume or guarantee the payment of any premium on insurance policies issued through its agency by its principal: And provided further, That the bank shall not guarantee the truth of any statement made by an assured in filing his application for insurance.

Sept. 7, 1916

Any member bank may accept drafts or bills of exchange drawn upon it having not more than

three months' sight to run, exclusive of days of grace, drawn under regulations to be prescribed by the Federal Reserve Board by banks or bankers in foreign countries or dependencies or insular possessions of the United States for the purpose of furnishing dollar exchange as required by the usages of trade in the respective countries, dependencies, or insular possessions. Such drafts or bills may be acquired by Federal reserve banks in such amounts and subject to such regulations, restrictions, and limitations as may be prescribed by the Federal Reserve Board: Provided, however, That no member bank shall accept such drafts or bills of exchange referred to in this paragraph for any one bank to an amount exceeding in the aggregate ten per centum of the paid-up and unimpaired capital and surplus of the accepting bank unless the draft or bill of exchange is accompanied by documents conveying or securing title or by some other adequate security: Provided further, That no member bank shall accept such drafts or bills in an amount exceeding at any time the aggregate of one-half of its paid-up and unimpaired capital and surplus.

Open Market Operations

SECTION FOURTEEN

Any Federal reserve bank may, under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers and bankers' acceptances and bills of exchange of the kinds and

maturities by this Act made eligible for rediscount, with or without the indorsement of a member bank.

Every Federal reserve bank shall have power:

(a) To deal in gold coin and bullion at home or abroad, to make loans thereon, exchange Federal reserve notes for gold, gold coin, or gold certificates, and to contract for loans of gold coin or bullion, giving therefor, when necessary, acceptable security, including the hypothecation of United States bonds or other securities which Federal reserve banks are authorized to hold;

(b) To buy and sell, at home or abroad, bonds and notes of the United States, and bills, notes, revenue bonds, and warrants with a maturity from date of purchase of not exceeding six months, issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues by any State, county, district, political subdivision, or municipality in the continental United States, including irrigation, drainage and reclamation districts, such purchases to be made in accordance with rules and regulations prescribed by the Federal Reserve Board;

(c) To purchase from member banks and to sell, with or without its indorsement, bills of exchange arising out of commercial transactions, as hereinbefore defined;

(d) To establish from time to time, subject to review and determination of the Federal Reserve Board, rates of discount to be charged by the Federal reserve bank for each class of paper, which shall be fixed with a view of accommodating commerce and business;

(e) To establish accounts with other Federal

reserve banks for exchange purposes and, with
June 21, 1917 the consent *or upon the order and direction* of the Federal Reserve Board*, and under regulations to be prescribed by said board*, to open and
Canceled Sept. 7, 1916 maintain ~~banking~~ accounts in foreign countries, appoint correspondents, and establish agencies in such countries wheresoever it may
June 21, 1917 *be* deem*ed* best for the purpose of purchasing, selling, and collecting bills of exchange, and to buy and sell, with or without its indorsement, through such correspondents or agencies, bills of exchange (*or acceptances*) arising out of actual commercial transactions which have not more than ninety days to run,
Sept. 7, 1916 *exclusive of days of grace*, and which bear the signature of two or more responsible parties*, and, with the consent of the Federal Reserve Board, to open and maintain banking accounts for such foreign correspondents or agencies.*
June 21, 1917 *Whenever any such account has been opened or agency or correspondent has been appointed by a Federal reserve bank, with the consent of or under the order and direction of the Federal Reserve Board, any other Federal reserve bank may, with the consent and approval of the Federal Reserve Board, be permitted to carry on or conduct, through the Federal reserve bank opening such account or appointing such agency or correspondent, any transaction authorized by this section under rules and regulations to be prescribed by the board.*

Note Issues

Section Sixteen

Federal reserve notes, to be issued at the discretion of the Federal Reserve Board for the

purpose of making advances to Federal reserve banks through the Federal reserve agents as hereinafter set forth and for no other purpose, are hereby authorized. The said notes shall be obligations of the United States and shall be receivable by all national and member banks and Federal reserve banks and for all taxes, customs, and other public dues. They shall be redeemed in gold on demand at the Treasury Department of the United States, in the city of Washington, District of Columbia, or in gold or lawful money at any Federal reserve bank.

Sept. 7, 1916 Any Federal reserve bank may make application to the local Federal reserve agent for such amount of the Federal reserve notes hereinbefore provided for as it may require. Such application shall be accompanied with a tender to the local Federal reserve agent of collateral in amount equal to the sum of the Federal reserve notes thus applied for and issued pursuant to such application. The collateral security thus offered shall be notes, *drafts*, ~~and~~ bills, ~~accepted for~~ *of exchange, or acceptances*

June 21, 1917 ~~rediscounted~~ *acquired* under the provi-
Sept. 7, 1916 sions of section 13 of this Act, ~~and the~~ *or bills of exchange indorsed by a member bank of any Federal reserve district and purchased under the provisions of section fourteen of this Act, or bankers' acceptances purchased under the provisions of said section fourteen*,

June 21, 1917 *, or gold or gold certificates; but in no event shall such collateral security, whether gold, gold certificates, or eligible paper, be less than the amount of Federal reserve notes applied for.* The Federal reserve agent shall each day notify the

Federal Reserve Board of all issues and withdrawals of Federal reserve notes to and by the Federal reserve bank to which he is accredited. The said Federal Reserve Board may at any time call upon a Federal reserve bank for additional security to protect the Federal reserve notes issued to it.

June 21, 1917 Every Federal reserve bank shall maintain reserves in gold or lawful money of not less than thirty-five per centum against its deposits and reserves in gold of not less than forty per centum against its Federal reserve notes in actual circulation: *Provided, however, That when the Federal reserve agent holds gold or gold certificates as collateral for Federal reserve notes issued to the bank such gold or gold certificates shall be counted as part of the gold reserve which such bank is required to maintain against its Federal reserve notes in actual circulation.* ~~and not offset by gold or lawful money deposited with the Federal reserve agent;~~ Notes so paid out shall bear upon their faces a distinctive letter and serial number, which shall be assigned by the Federal Reserve Board to each Federal reserve bank. Whenever Federal reserve notes issued through one Federal reserve bank shall be received by another Federal reserve bank, they shall be promptly returned for credit or redemption to the Federal reserve bank through which they were originally issued, *or, upon direction of such Federal reserve bank, they shall be forwarded direct to the Treasurer of the United States to be retired.* No Federal reserve bank shall pay out notes issued through another under penalty of a tax of ten per centum upon the face value of notes

so paid out. Notes presented for redemption at the Treasury of the United States shall be paid out of the redemption fund and returned to the Federal reserve banks through which they were originally issued, and thereupon such Federal reserve bank shall, upon demand of the Secretary of the Treasury, reimburse such redemption fund in lawful money or, if such Federal reserve notes have been redeemed by the Treasurer in gold or gold certificates, then such funds shall be reimbursed to the extent deemed necessary by the Secretary of the Treasury in gold or gold certificates, and such Federal reserve bank shall, so long as any of its Federal reserve notes remain outstanding, maintain with the Treasurer in gold an amount sufficient in the judgment of the Secretary to provide for all redemptions to be made by the Treasurer. Federal reserve notes received by the Treasury~~er~~ otherwise than for redemption may be exchanged for gold out of the redemption fund hereinafter provided and returned to the reserve bank through which they were originally issued, or they may be returned to such bank for the credit of the United States. Federal reserve notes unfit for circulation shall be returned by the Federal reserve agents to the Comptroller of the Currency for cancellation and destruction.

June 21, 1917 The Federal Reserve Board shall require each Federal reserve bank to maintain on deposit in the Treasury of the United States a sum in gold sufficient in the judgment of the Secretary of the Treasury for the redemption of the Federal reserve notes issued to such bank, but in no event less than five per centum~~,~~ *of the total*

amount of notes issued less the amount of gold or gold certificates held by the Federal reserve agent as collateral security; but such deposit of gold shall be counted and included as part of the forty per centum reserve hereinbefore required. The board shall have the right, acting through the Federal reserve agent, to grant, in whole or in part, or to reject entirely the application of any Federal reserve bank for Federal reserve notes; but to the extent that such application may be granted the Federal Reserve Board shall, through its local Federal reserve agent, supply Federal reserve notes to the banks so applying, and such bank shall be charged with the amount of ~~such~~ notes *issued to it* and shall pay such rates of interest ~~on said amount~~ as may be established by the Federal Reserve Board, ~~and the~~ *on only that* amount of such *notes which equals the total amount of its outstanding Federal reserve notes less the amount of gold or gold certificates held by the Federal reserve agent as collateral security.* Federal reserve notes ~~so~~ issued to any such bank shall, upon delivery, together with such notes of such Federal reserve bank as may be issued under section eighteen of this Act upon security of United States two per centum Government bonds, become a first and paramount lien on all the assets of such bank.

Any Federal reserve bank may at any time reduce its liability for outstanding Federal reserve notes by depositing, with the Federal reserve agent, its Federal reserve notes, gold, gold certificates, or lawful money of the United States. Federal reserve notes so deposited shall not be reissued, except upon compliance with the conditions of an original issue.

June 21, 1917 The Federal reserve agent shall hold such gold, gold certificates, or lawful money available exclusively for exchange for the outstanding Federal reserve notes when offered by the reserve bank of which he is a director. Upon the request of the Secretary of the Treasury the Federal Reserve Board shall require the Federal reserve agent to transmit *to the Treasurer of the United States* so much of ~~said~~ *the* gold ~~to the Treasury of the United States~~ *held by him as collateral security for Federal reserve notes* as may be required for the exclusive purpose of the redemption of such *Federal reserve* notes*, but such gold when deposited with the Treasurer shall be counted and considered as if collateral security on deposit with the Federal reserve agent.*

June 21, 1917 Any Federal reserve bank may at its discretion withdraw collateral deposited with the local Federal reserve agent for the protection of its Federal reserve notes ~~deposited with~~ *issued to* it and shall at the same time substitute therefor other ~~like~~ collateral of equal amount with the approval of the Federal reserve agent under regulations to be prescribed by the Federal Reserve Board. *Any Federal reserve bank may retire any of its Federal reserve notes by depositing them with the Federal reserve agent or with the Treasurer of the United States, and such Federal reserve bank shall thereupon be entitled to receive back the collateral deposited with the Federal reserve agent for the security of such notes. Federal reserve banks shall not be required to maintain the reserve or the redemption fund heretofore provided for against Federal reserve notes which have been retired. Federal reserve notes so deposited shall not be*

reissued except upon compliance with the conditions of an original issue.

June 21, 1917 *All Federal reserve notes and all gold, gold certificates, and lawful money issued to or deposited with any Federal reserve agent under the provisions of the Federal reserve Act shall hereafter be held for such agent, under such rules and regulations as the Federal Reserve Board may prescribe, in the joint custody of himself and the Federal reserve bank to which he is accredited. Such agent and such Federal reserve bank shall be jointly liable for the safe-keeping of such Federal reserve notes, gold, gold certificates, and lawful money. Nothing herein contained, however, shall be construed to prohibit a Federal reserve agent from depositing gold or gold certificates with the Federal Reserve Board, to be held by such board subject to his order, or with the Treasurer of the United States for the purposes authorized by law.*

June 21, 1917 *That the Secretary of the Treasury is hereby authorized and directed to receive deposits of gold coin or of gold certificates with the Treasurer or any assistant treasurer of the United States when tendered by any Federal reserve bank or Federal reserve agent for credit to its or his account with the Federal Reserve Board. The Secretary shall prescribe by regulation the form of receipt to be issued by the Treasurer or Assistant Treasurer to the Federal Reserve bank or Federal reserve agent making the deposit, and a duplicate of such receipt shall be delivered to the Federal Reserve Board by the Treasurer at Washington upon proper advices from any assistant treasurer that such deposit has been made. Deposits so made shall be held subject to the orders of the Federal Reserve*

Board and shall be payable in gold coin or gold certificates on the order of the Federal Reserve Board to any Federal reserve bank or Federal reserve agent at the Treasury or at the Subtreasury of the United States nearest the place of business of such Federal reserve bank or such Federal reserve agent: Provided, however, That any expense incurred in shipping gold to or from the Treasury or subtreasuries in order to make such payments, or as a result of making such payments, shall be paid by the Federal Reserve Board and assessed against the Federal reserve banks. The order used by the Federal Reserve Board in making such payments shall be signed by the governor or vice governor, or such other officers or members as the board may by regulation prescribe. The form of such order shall be approved by the Secretary of the Treasury.

June 21, 1917 *The expenses necessarily incurred in carrying out these provisions, including the cost of the certificates or receipts issued for deposits received, and all expenses incident to the handling of such deposits shall be paid by the Federal Reserve Board and included in its assessments against the several Federal reserve banks.*

June 21, 1917 *Gold deposits standing to the credit of any Federal reserve bank with the Federal Reserve Board shall, at the option of said bank, be counted as part of the lawful reserve which it is required to maintain against outstanding Federal reserve notes, or as a part of the reserve it is required to maintain against deposits.*

June 21, 1917 *Nothing in this section shall be construed as amending section six of the act of March fourteenth, nineteen hundred, as amended by the acts*

of March fourth, nineteen hundred and seven, March second, nineteen hundred and eleven, and June twelfth, nineteen hundred and sixteen, nor shall the provisions of this section be construed to apply to the deposits made or to the receipts or certificates issued under those acts.

Bank Reserves

SECTION NINETEEN

June 21, 1917 Demand deposits within the meaning of this Act shall comprise all deposits payable within thirty days, and time deposits shall comprise all deposits payable after thirty days, ~~and~~ all savings accounts and certificates of deposit which are subject to not less than thirty days' notice before payment*, and all postal savings deposits.*

June 21, 1917 ~~When the Secretary of the Treasury shall have officially announced, in such manner as he may elect, the establishment of a Federal reserve bank in any district, e~~ *Every* ~~subscribing member~~ bank, *banking association, or trust company which is or which becomes a member of any Federal reserve bank* shall establish and maintain reserve~~s~~ *balances with its Federal reserve bank* as follows:

June 21 1917 (a) ~~A bank~~ *If* not in a reserve or central reserve city, as now or hereafter defined, *it* shall hold and maintain ~~reserves equal to twelve~~ *with the Federal reserve bank of its district an actual net balance equal to not less than seven* per centum of the aggregate amount of its demand deposits and ~~five~~ *three* per centum of its time deposits*.* ~~as follows:~~

~~In its vaults for a period of thirty-six months~~

~~after said date five-twelfths thereof and permanently thereafter four-twelfths.~~

~~In the Federal reserve bank of its district, for a period of twelve months after said date, two-twelfths, and for each succeeding six months an additional one-twelfth, until five-twelfths have been so deposited, which shall be the amount permanently required.~~

~~For a period of thirty-six months after said date the balance of the reserves may be held in its own vaults, or in the Federal reserve bank, or in national banks in reserve or central reserve cities, as now defined by law.~~

~~After said thirty-six months' period said reserves, other than those hereinbefore required to be held in the vaults of the member bank and in the Federal reserve bank, shall be held in the vaults of the member bank or in the Federal reserve bank, or in both, at the option of the member bank.~~

(b) ~~A bank~~ *If* in a reserve city, as now or hereafter defined, *it* shall hold and maintain ~~reserves~~ *with the Federal reserve bank of its district an actual net balance* equal to *not less than* ~~fifteen~~ *ten* per centum of the aggregate amount of its demand deposits and five *three* per centum of its time deposits~~, as follows:~~

June 21, 1917 ~~In its vaults for a period of thirty-six months after said date six-fifteenths thereof, and permanently thereafter five-fifteenths.~~

~~In the Federal reserve bank of its district for a period of twelve months after the date aforesaid at least three-fifteenths, and for each succeeding six months an additional one-fifteenth until six-fifteenths have been so deposited, which shall be the amount permanently required.~~

~~For a period of thirty-six months after said date the balance of the reserves may be held in its own vaults, or in the Federal reserve bank or in national banks in~~

Aug. 15, 1914 ~~reserve or~~
June 21, 1917 ~~central reserve cities as now defined by law.~~

~~After said thirty-six months' period all of said reserves, except those hereinbefore required to be held permanently in the vaults of the member bank and in the Federal reserve bank, shall be held in its vaults or in the Federal reserve bank or in both, at the option of the member bank.~~

(c) ~~A bank~~ *If* in a central reserve city, as now or hereafter defined, *it* shall hold and maintain ~~a reserve~~ *with the Federal reserve bank of its district an actual net balance* equal to *not less than* ~~eighteen~~ *thirteen* per centum of the aggregate amount of its demand deposits and ~~five~~ *three* per centum of its time deposits~~, as follows:~~

June 21, 1917 ~~In its vaults six-eighteenths thereof.~~

~~In the Federal reserve bank, seven-eighteenths.~~

~~The balance of said reserves shall be held in its own vaults or in the Federal reserve bank, at its option.~~

~~Any Federal reserve bank may receive from the member banks as reserves, not exceeding one-half of each installment, eligible paper as described in section fourteen~~ Aug. 15, 1914 ~~—— *thirteen*~~ June 21, 1917 ~~properly indorsed and acceptable to the said reserve bank.~~

Aug. 15, 1914 ~~If a State bank or trust company is required~~
Canceled ~~*or permitted* by the law of its State to keep its~~
June 21, 1917 ~~reserves either in its own vaults or with another State bank or trust company, *or with a national*~~

~~*bank*, such reserve deposits so kept in such State bank, or trust company, *or National bank* shall be construed, within the meaning of this section, as if they were reserve deposits in a national bank in a reserve or central reserve city for a period of three years after the Secretary of the Treasury shall have officially announced the establishment of a Federal reserve bank in the district in which such State bank or trust company is situate. Except as thus provided, no~~

June 21, 1917 *No* member bank shall keep on deposit with any ~~nonmember~~ *State* bank *or trust company which is not a member bank* a sum in excess of ten per centum of its own paid-up capital and surplus. No member bank shall act as the medium or agent of a nonmember bank in applying for or receiving discounts from a Federal reserve bank under the provisions of this Act, except by permission of the Federal Reserve Board.

June 21, 1917 The ~~reserve~~ *required balance* carried by a member bank with a Federal reserve bank may, under the regulations and subject to such penalties as may be prescribed by the Federal Reserve Board, be checked against and withdrawn by such member bank for the purpose of meeting existing liabilities: *Provided, however*, That no bank shall at any time make new loans or shall pay any dividends unless and until the total ~~reserve~~ *balance* required by law is fully restored.

June 21, 1917 In estimating the ~~reserves~~ *balances* required by this Act, the net ~~balance~~ *difference* of amounts due to and from other banks shall be taken as the basis for ascertaining the

Aug. 15, 1914 ~~*bank*~~

Canceled June 21, 1917

deposits against which ~~reserves~~ *required balances with Federal reserve banks* shall be determined. ~~Balances in reserve banks due to member banks shall, to the extent herein provided, be counted as reserves.~~

June 21, 1917

National banks, *or banks organized under local laws*, located in Alaska or *in a dependency or insular possession or any part of the United States* outside the continental United States may remain nonmember banks, and shall in that event maintain reserves and comply with all the conditions now provided by law regulating them; or said banks, ~~except in the Philippine Islands,~~ may, with the consent of the Reserve Board, become member banks of any one of the reserve districts, and shall, in that event, take stock, maintain reserves, and be subject to all the other provisions of this Act.

Foreign Branches

SECTION TWENTY-FIVE

Sept. 7, 1916

Any national banking association possessing a capital and surplus of $1,000,000 or more may file application with the Federal Reserve Board, *for permission to exercise*, upon such conditions and under such regulations as may be prescribed by the said board, ~~for the purpose of securing authority to~~ *either or both of the following powers:*

First. To establish branches in foreign countries or dependencies *or insular possessions* of the United States for the furtherance of the foreign commerce of the United States, and to act, if required to do so, as fiscal agents of the United States.

Second. To invest an amount not exceeding in the aggregate ten per centum of its paid-in capital stock and surplus in the stock of one or more banks or corporations chartered or incorporated under the laws of the United States or of any State thereof, and principally engaged in international or foreign banking, or banking in a dependency or insular possession of the United States either directly or through the agency, ownership, or control of local institutions in foreign countries, or in such dependencies or insular possessions.

Sept. 7, 1916 Such application shall specify, ~~in addition to~~ the name and capital of the banking association filing it, *the powers applied for, and the* place or places where the banking operations proposed are to be carried on, ~~and the amount of capital set aside for the conduct of its foreign business.~~ The Federal Reserve Board shall have power to approve or to reject such application ~~if, in its judgment, the amount of capital proposed to be set aside for the conduct of foreign business is inadequate, or~~ *in whole or in part* if for ~~other~~ *any* reasons the granting of such application is deemed inexpedient, *and shall also have power from time to time to increase or decrease the number of places where such banking operations may be carried on.*

Sept. 7, 1916 Every national banking association ~~which shall receive authority to establish foreign branches~~ *operating foreign branches* shall be required ~~at all times~~ to furnish information concerning the condition of such branches to the Comptroller of the Currency upon demand, *and every member bank investing in the capital stock of banks or corporations described under subparagraph two of*

the first paragraph of this section shall be required to furnish information concerning the condition of such banks or corporations to the Federal Reserve Board upon demand, and the Federal Reserve Board may order special examinations of the said ~~foreign~~ branches, *banks, or corporations* at such time or times as it may deem best.

Sept. 7, 1916 *Before any national bank shall be permitted to purchase stock in any such corporation the said corporation shall enter into an agreement or undertaking with the Federal Reserve Board to restrict its operations or conduct its business in such manner or under such limitations and restrictions as the said board may prescribe for the place or places wherein such business is to be conducted. If at any time the Federal Reserve Board shall ascertain that the regulations prescribed by it are not being complied with, said board is hereby authorized and empowered to institute an investigation of the matter and to send for persons and papers, subpœna witnesses, and administer oaths in order to satisfy itself as to the actual nature of the transactions referred to. Should such investigation result in establishing the failure of the corporation in question, or of the national bank or banks which may be stockholders therein, to comply with the regulations laid down by the said Federal Reserve Board, such national banks may be required to dispose of stock holdings in the said corporation upon reasonable notice.*

Sept. 7, 1916 Every such national banking association shall conduct the accounts of each foreign branch independently of the accounts of other foreign branches established by it and of its home office, and shall at the end of each fiscal period transfer

to its general ledger the profit or loss accru~~ing~~*ed* at each branch as a separate item.

Sept. 7, 1916 *Any director or other officer, agent, or employee of any member bank may, with the approval of the Federal Reserve Board, be a director or other officer, agent, or employee of any such bank or corporation above mentioned in the capital stock of which such member bank shall have invested as hereinbefore provided, without being subject to the provisions of section eight of the Act approved October fifteenth, nineteen hundred and fourteen, entitled "An Act to supplement existing laws against unlawful restraints and monopolies, and for other purposes."*

PART TWO

APPENDICES

APPENDIX ONE

LETTER TO HON. THEODORE E. BURTON

New York, N. Y.
April 30th, 1908

Hon. Theodore E. Burton
House of Representatives
Washington, D. C.

Dear Mr. Burton:

I beg to acknowledge receipt of your yesterday's letter, which I have read with much interest, and for which I thank you. I assure you that it was the greatest pleasure for me to be of whatever little help I could be in this matter. You certainly do not owe me any thanks but we all have to thank you for the fight that you are making for sound currency legislation, and it is more than sad that the chances to pass a satisfactory bill are so poor. I am trying to work out in a somewhat final shape my pet scheme of a "Modified Central Bank." Having been one of the first champions of such an organization and having tried to put in a fight for it during almost two years, I have been repeatedly requested to show in black and white what I would propose. The little pamphlet that I have prepared embodies these ideas of mine, which I have prefaced by a short statement of what I consider the fundamental principles, which must be borne in mind in the framing of currency legislation.

As I hope to leave for Europe on May 7th, I did not want to leave before having laid down these ideas of mine. It was my intention to send a copy of this pamphlet to every national and state bank, and also to every member of the legislature. I believe that the question whether we shall finally be able to secure sound currency legislation, will largely depend on a broad campaign of education, and I would like to do my part in it.

I hope you will not consider this intention of mine as an evidence of conceit, but it is the poor work done by others in this matter

and the lack of knowledge shown by those who ought to know better and must know better before anything can be achieved, which makes me feel that I have a duty to perform. I must confess that I would appreciate it very much if this bill of mine could be introduced, so as to place it on record, and so as to secure for it some place in the consideration of the problem, which probably will have to follow whatever may be decided upon now, be it a commission or a temporary measure. I wonder whether it would be improper for me to ask whether you or Mr. Parsons would be willing to introduce this bill "by request or by courtesy" which would not commit the gentleman introducing this bill to champion it as if it were his own, although, of course, I need not add how much I would appreciate it if my "child" would find a strong father. Please do not hesitate to write me with full frankness about this matter, which I assure you I shall all the more appreciate.

With assurances of highest respect, I beg to remain

Very truly yours,

PAUL M. WARBURG

APPENDIX TWO

LETTER TO SENATOR ALDRICH

New York, December 31st, 1907

DEAR SENATOR ALDRICH:

Since I had the pleasure of seeing you, I have carefully considered the interesting scheme which you outlined for creating an additional currency, using as a basis clearing-house certificates. You were kind enough to say that you would be interested to receive any further suggestions on this subject, and this encourages me to write to you frankly what has occurred to me since on careful consideration of the question.

I heartily agree with the object in view, and sincerely congratulate you upon the strong attitude you have taken against the asset-currency plan. I believe, however, there might be some weighty objections to the combination of the government bond-secured national bank note and the national bank note secured by clearing-house certificates. Does not the financial history of all nations show the generally adopted tendency of divorcing the power of issuing notes from the power of doing a general commercial business, as done by the national banks? It strikes me that it would be better to do away with some of the restrictions now placed upon the national banks as, for instance, the limitation to endorse paper, as to accepting and to certifying, etc., than to give them additional note-issuing powers which logically should lead to a further restriction of their privileges. While the government bond-secured national bank note did splendid service to meet the conditions of the past, would it not be well to create a *new* note to be issued by a central clearing house, or whatever this institution may be, and to let this new elastic note issue grow in extent and, possibly, to stop any further issue of government-secured notes? Did not the last panic show that we are suffering from too much decentralization of our banking system and from the absolute impossibility of securing any concerted action as to the free use of

our reserves, instead of competitive hoarding of currency by the financial institutions? All these objectionable features might be removed if the future issue of notes against clearing-house certificates would not be left to the judgment of each clearing house and as far as the physical issue is concerned, to each national bank. But, if one independent organ would be created, to sit in final judgment on the question whether the collateral is good and where and whether the notes are to be issued, and to issue one kind of a note, guaranteed by the United States—payable in gold, and secured by an independent gold reserve—the situation would be greatly improved, and not only expansion, but also effective contraction would be secured.

I cannot help fearing that under your plan precarious situations might arise. Suppose one particular clearing-house district, say, for instance, Pittsburgh, would be heavily over-extended, and desired to issue clearing-house certificates, while all the other clearing-house districts of the country would not be in any extended situation, and would feel that, instead of granting further accommodation, a wise restriction would be preferable. The members of the clearing-house in Pittsburgh, having possibly all the same interests, and being possibly all under the same influence of—perhaps—over-optimism, might misjudge the situation. In this case, there is no authority, no central board of a national clearing house to pass on the question whether the notes ought to be issued or not. Besides, if they are issued, possibly to pay for indebtedness in other clearing-house districts, they might be promptly presented for exchange into government notes, unless they are clearly guaranteed by the United States. . . . For all these considerations, I am rather inclined to believe that some kind of a central clearing house should be created which would stand between the government and the local clearing houses, which would issue its own notes, guaranteed by the United States Government, and which would be able, instead of issuing these notes automatically at 6 per cent, to raise the rate of interest even above this rate. In given instances, it would refuse altogether to give advances, and it would give these advances for certain periods, so that it can insure contraction of its outstanding notes.

I do not know whether you have found the time to read the

draft for the organization of a central clearing house, which I took the liberty of sending you at your kind suggestion. However, after having had the advantage of hearing your views, I am afraid that you will feel that even those very limited powers that I had planned to be given to the central clearing house, might prove fatal to its ever being created. But you will readily see on glancing through my paper that this plan is susceptible of many modifications; it would be perfectly feasible, if absolutely necessary, to withhold from the central clearing house the power to discount any paper, except through the clearing houses and, if unavoidable, one might even take away the power to receive the government's moneys. The latter privilege was inserted for the purpose of securing for the central clearing house a regular income and for increasing its gold reserve and, through that, its general power of being of benefit. But even if stripped of these two very important privileges, a central clearing house would be a big step in advance and, which is most important, a step in the right direction.

I most sincerely apologize for taking the liberty of writing to you at such length, but I am so deeply interested in the question, that I cannot withstand the temptation of submitting my views to the man who will be all-important in working out this scheme. If, at any time, I can be useful, please be assured that I shall be only too glad to hold myself at your disposal.

With assurances of highest esteem, I beg to remain

Very truly yours,

Paul M. Warburg

APPENDIX THREE

STATEMENT BEFORE THE SUBCOMMITTEE OF THE COMMITTEE ON BANKING AND CURRENCY OF THE HOUSE OF REPRESENTATIVES, JANUARY 7, 1913

The earnest study that has been devoted during these last years to the question of monetary and banking reform has had this tangible result that the roots of the evils of our present system are now clearly understood. While a few years ago the opinion generally prevailed that we were suffering primarily or even exclusively from the effects of an inelastic note issue, it is now clearly recognized that this defect of our system is not the main question, but that the more important and fundamental shortcomings of our system are decentralized and therefore inefficient cash reserves and the immobilization of the commercial paper held by our banks.

It may be safe to add that with the clear recognition of the disease, common agreement has been reached as to the organs that must be treated, and it is now generally conceded by the majority of students of the question that a remedy for these three evils—decentralized reserves, immobilized commercial paper, and inelastic note issue—will have to be found by any legislation that is to bring permanent and thorough relief. It is not so generally understood that of these three evils the decentralization of our cash reserves is the most fundamental one, and that by creating a properly organized system of centralized reserves the remedy for all three evils, and the defects that in turn follow them, can be and must be found.

The point that, with your kind permission, I wish to emphasize is that this work of reform cannot be done in a haphazard way by treating each phase separately, but that centralization of reserves, mobilization of credit, and elastic note issue go together—they follow automatically a properly organized concentration and coöperation of reserves.

This interrelation becomes quite apparent to us when we stop to consider that, in case of the organization of such a central reserve, neither the banks nor the central reserve itself would be safe without the introduction of commercial or banking paper as a means of exchange. The banks would not be safe, because they could not permit a substantial portion of their cash reserves to be kept by the central reserve, unless they could rely on two things: first, that at all times they could obtain gold against their cash balances, if actual cash were required from them, and second, that they would at all times have the means wherewith to build up their cash balances with the central reserve, in case increased demands for cash would be made upon them. This means of exchange, the key, if you please, to the vaults of the central reserve, is furnished by commercial or banking paper. Without this key a central reserve would be absolutely useless and therefore impracticable for the banks.

On the other hand, a central reserve would not be safe, if it were nothing but an automatic strong-box, receiving cash as it would be paid in, and paying it out as it might be required. In order to be safe, and in order to be able to protect the nation, the central reserve must be in a position to increase at will its investments in commercial paper and, vice versa, to reinforce its cash holdings by collecting maturing paper, strengthening or loosening, whichever the case may be, its hold on the market, and protect its own position, as against its aggregate on demand gold obligations at home and as against other countries. Without this ability of collecting or acquiring local or foreign paper, both at home and abroad, the central reserve would not be safe.

It would be a great national achievement in itself to bring about this mobilization of credit and the creation of an important world-wide discount market, which in turn would have, as a sequence, the turning into a broad bill market of the many millions that now flood and over-flood Wall Street. But, we must bear in mind that it is an incidental, though necessary, development following the creation of a central reserve as, inversely, the creation of an effective central reserve is dependent upon the system of free exchange of commercial and banking paper. The two cannot be separated.

An elastic note issue is an additional and most effective weapon of defense of a central reserve, without which it would be well-nigh impossible for the latter to perform its main functions of maintaining, without exorbitant fluctuations in interest rates, a proper proportion between all demand obligations and actual gold reserves. A scientific and effective elastic note issue must be covered by gold and commercial paper in a safe proportion, just the same as the general deposit obligations of a central institution. Bank notes are deposits in bearer form. They can be turned into deposits at will as, inversely, deposits can be turned into notes at the will of the owner. Both deposits and notes are payable in gold and the centralized reserves cover indiscriminately the one and the other. They, therefore, must be treated together and cannot be dealt with by separate laws. Elastic note issue cannot be created without a central reserve, nor without the existence of liquid commercial paper, nor can an efficient central reserve be established without the power of elastic note issue. They all go hand in hand.

Inasmuch as it is generally recognized that the creation of a discount market is most desirable and of the highest importance for the nation, it has been frequently suggested that legislation might start with the creation of such a market and leave the rest to follow later.

The object of my argument was to show that such a course would be impossible. American commercial paper will not be considered a quick asset and will not take the place of the stock-exchange call loan unless the purchasers—both local and foreign—know that there will be a possibility of rediscounting a safe proportion of their holdings, if need be, with a central institution. While as a matter of fact the actual rediscounting by central institutions may be unimportant in normal times, the existence of such central institutions creates the ultimate basis of confidence without which a discount market cannot be developed. No law can create a discount market without a central reserve; without the latter our paper would remain provincial and local and a "lock up" as heretofore.

Others have advocated banking legislation creating a net of local reserve centers all over the country, having in mind that a general scheme of connecting these local reserve centers into one central institution could be perfected at some future time. This,

too, is not a practical plan. Unless a central reserve be endowed with a large capital of its own and unless we bring about a free return flow of all idle cash into one central reservoir, from where, without the least possible friction it can be directed to wherever it is legitimately wanted, there cannot be created that confidence which is the basis of the entire structure. The banks would not rely entirely upon the ultimate strength of their local reserve centers and consequently they would hold back in their vaults more cash than would be permissible for the safety of the local reserve centers and the entire community. These local reserve centers, each in turn, would try to accumulate the largest possible amount of cash and, in times of stress, we would witness exactly the same conditions which we saw during the panic of 1907. Instead of a free return flow of idle cash, we would have created a large number of hoarding centers and we would experience again a period of gold premium between one center and the other, and local runs and havoc would follow. Moreover, in the majority of the zones there would not exist a sufficiently important banking power to organize local reserves of adequate size. The strongest local reserve—no doubt that of the city of New York—would therefore dominate, because it would be to that center that all the country, in normal and abnormal times, would appeal for help. A system of that kind would enormously increase the financial power of New York even beyond the measure enjoyed to-day. Furthermore, the power that lies in union would be lost by such a system of local reserve centers, which could neither accumulate a large reserve of foreign exchange, as a weapon for warding off gold exports, nor would they have any of the protective or preventive powers which would benefit the nation under a strong scheme of federated reserves.

It would appear then without much doubt that the solution for our country must be sought on the lines of centralized reserves, the same system, though in a form not so highly developed, as that of the European central institutions, the effectiveness of which we have admired again and again in these recent years. This system has helped comparatively weak nations to stand phenomenal strains without any such calamity as overcame this country under much less trying conditions.

That part of the plan of the Monetary Commission which is expressive of these principles has been generally recognized as sound and as containing no more than a practicable adaptation of methods which have been successfully tried by all other financial powers of the globe.

The difference of opinion concerning the proper methods to be applied in our country exists more regarding the shell than the kernel. The two questions that remain to be solved to the satisfaction of the nation are mainly those of form and control.

Less importance, I believe, is being attached to the first question. *It will not be difficult to reach an agreement as to whether this central reserve shall be a simple federation of banks, under some kind of a joint responsibility and without a capital of its own, or whether it shall be a corporation endowed with a large capital* and, if so, whether the *banks shall* be its *only stockholders*, or whether the stock should be kept indiscriminately and widely scattered. The harder problem, on the proper solution of which the fate of the entire measure appears to depend, is that of finding the formula for constituting control and management in a way that will create absolute confidence and, at the same time, satisfy the people.

There are those who claim that the institution should be managed like the Bank of England, by business men alone, without any government interference (this is the scheme which evidently appealed most to the framers of the National Monetary Commission's Plan); there are those again who claim that the issuing of money with almost legal-tender powers is a semi-governmental function and that, therefore, the government should have a larger share in the running of the institution, a principle applied by our sister republic in establishing the "Board of Regents" of the Banque de France. There are even those who claim that the government should issue these notes directly without the creation of any special independent organ for this purpose.

It does not seem necessary to deal at length with this latter contention. Once we have recognized clearly that commercial paper must be the basis of a scientific note issue, we can see at a glance where it would lead if the Treasury should become the organ for the purchase and sale and the collection of such paper. It would end in disaster.

The same argument applies, though to a somewhat lesser degree, to the question of the management of a central institution by exclusive government administration; it, too, would be fatal. It would without fail bring politics into business and business into politics.

On the other hand, it is evident, that if the power of managing this institution were to be placed exclusively in the hands of banks and business men, it would create alarm and suspicion.

To my mind, a proper solution would be division of power between these two factors. If the government, in addition to the *ex officio* members, appointed a little more than half of the members of the board of the central office, and the other half were appointed by the banks from all parts of the country, and if the boards of the branches were constituted in a similar way, possibly giving a slight majority to the banking element on these branch boards, it seems probable that both sides would protect each other against temptation, insinuation, and suspicion. In any case, there would be no difficulty in finding some modus by which the government would exercise effective supervision and control over a management, the direction of which would have the advantage of the experience and acumen of the business and banking community.

It is generally understood that such a central institution would have to be restricted in its functions. It should deal only with banks and trust companies and should be so constructed that it would protect and strengthen the independence of the more than 20,000 banking units now in existence. It should be restricted in its dealings to transactions in commercial and banking paper, both domestic and foreign, and to investments in United States Government securities and Treasury notes. It should, furthermore, be restricted as to the amounts that it might purchase from each institution, and provision should be made which would carefully safeguard the central institution, by a system of joint guarantees or otherwise, in case such limits had to be surpassed. This would protect the banks of the country and, incidentally, it would bring about a network of bulwarks which would shield the central institution from attacks both from within and from without.

It is evident why a central bank with all the wide powers enjoyed by the European institutions, could not be conscientiously planned

for our country. It would interfere with the business and independence of the existing banks, and by the power of dealing with individuals and individual firms the door would at once be opened for dangerous abuses which must be avoided at all hazards. Control of such an institution, both at the head office and the branches, would give such vast power that, no matter whether government officials or business men were in charge, sooner or later it would become the instrument of selfish ambition.

In framing this law we must clearly consider existing conditions. The business man who wants to help in this work must forget his own interests and must not try to belittle the possible dangers of selfish motives and boundless ambition on the part of business men or bankers, from which the future federation of reserves must be protected with absolute certainty. The legislator, on the other hand, must view the question with equal frankness and courage; he cannot be blind to the dangers that would follow if the government were to be dragged into business, and he dare not disregard the fact that in order to serve the public interest best, this institution must have the hearty and healthy coöperation of the best business elements from all sections of the country.

This central reserve, or whatever name we may give it, must be a sacred institution run for the public weal, without consideration of personal gain by anyone connected with it.

If in order to secure this we have to forego the fullest satisfaction of our pride and ambitions, by accepting the less perfect form of a strongly restricted central reserve instead of a highly developed central bank, we may still be satisfied with establishing a system that will enable us to develop along modern lines and that will give us safety and immunity from panics—without the institution becoming a danger to our political and social life.

There is no difficulty in evolving such a plan. The country demands with impatience that it should be done without any further delay.

The statement gave rise to the following colloquy between the writer and Mr. Glass:

The Chairman. Would you say that we should do nothing if we cannot at this time get a central reserve association?

Mr. Warburg. That is a very hard question to answer, because

it is a tremendous responsibility to say that. I feel very strongly that, as I have tried to explain in what I have said to you, when you will come to write a law of regional reserves on the lines that Mr. Morawetz suggested, you would find very soon that either it would not be protection, or that it would depend on New York and Chicago, and would make those the centers, just the thing you want to avoid; or that, if you wanted to make the system effective, you would have to write so many conditions, how the various reserve centers shall place their funds at the disposition of each other, that it would be again a centralization of reserves.

I think that when you will be well under way in trying to work this out, you will find that you will come toward a centralized reserve system in some form. There are several forms. It need not be done on the plan on which the Monetary Commission proceeded, but I think that the kernel of it must tend toward an effective centralization of reserves, or I do not think you will get anywhere.

The Chairman. You do not agree with Mr. Hepburn, then, that the coöperation of banks throughout the country in the regional reserve associations would be infinitely better than the existing system?

Mr. Warburg. It may amount to something. I am very skeptical of these general plans of saying a system of that kind should be worked out. I have challenged Mr. Morawetz already in 1910 to produce a definite plan of that kind, and have told him then that he would find that he would have to take one horn or the other of the dilemma; that either he would produce an inefficient and dangerous system, or that it would lead toward a strong centralization of reserves in a very roundabout way, which would not be as effective as a straight-forward central reserve.

The Chairman. That is what you are trying to arrive at, a centralization of reserves?

Mr. Warburg. It is not that I am trying to arrive at it, Mr. Chairman. It is to my mind—and I have studied this thing very, very carefully for a great many years—the only way, the fundamental way, in which every other country in the world has been treating this; and it is the only effective way in which it can be

treated, and it need not be a central bank. We have forgotten in this country to make that clear.

The Chairman. Yes.

Mr. Warburg. It is not necessary to have that centralization of reserves in a central bank. I am opposed to a central bank for the United States.

The Chairman. Do you think the so-called Aldrich Plan is or is not practically that of a central bank?

Mr. Warburg. I do not consider that a central bank for this reason. Of course we have to be technical, and we have to define it pretty clearly. A bank is an institution that does business broadly. A central bank in this country would have the right to deal with anybody else. It would have the right, as the European banks have, to make loans on stocks and bonds. It would have branches all over the country and would be the strongest competitor of the banks, as the European central banks are. The Reichsbank and the Bank of France are active competitors, and they claim that only through that can they hold that effective grip upon the market that they need. That is their excuse for it.

Now, it is conceded that a central reserve would not be as effective in its hold on the market as a central reserve bank would be. But in Europe they have not got the large cash balances that the banks have in this country, and if you could devise a scheme by which those balances could be made coöperative it would fulfill all requirements, and you would get safety from panics without a central bank. You would not get safety from an occasional crisis; crises you cannot prevent. But a collapse of your system can be prevented under such a system. That I do not think can be prevented under a system of regional reserves if you get a real strain. Little things will not upset it; but if we should get into a real serious entanglement as the European countries did just now —and that may happen—a system of decentralized reserves would not stand the strain for a moment.[1]

[1] The remainder of the testimony containing largely colloquy with other members of the Subcommittee has not been reprinted.

APPENDIX FOUR

REPORT OF DELEGATES FROM THE NEW YORK STATE CHAMBER OF COMMERCE TO THE MONETARY CONFERENCE IN WASHINGTON, JANUARY 18, 1911

To the Chamber of Commerce:

The undersigned, who were appointed delegates of the Chamber to the Monetary Conference of the National Board of Trade at Washington on January 18th, 1911, beg leave to submit the following report:

At the first meeting held by your delegates early in January in New York, there was reached complete unanimity that the solution of the problem of monetary reform in the United States is to be sought on the lines of a central organization and on the broad principles governing European central banks. These views were thereupon briefly formulated.

From a report prepared by a Committee of the New York Produce Exchange and from earlier statements issued by the Committee on Finance and Currency of the Merchants' Association, both of which bodies had also accepted invitations to be present at the said conference at Washington, it became evident that it might be possible for the delegates of the three important commercial bodies of New York to agree upon one resolution, to be jointly introduced at the convention.

Your delegates therefore brought about a conference with the delegates of the Merchants' Association and the New York Produce Exchange, at which preambles and resolutions were agreed upon recommending the adoption of a central organization and setting forth at length the general principles which should govern its creation and operation.

On January 18th all of your delegates were in attendance at Washington to participate at the conference which took place under the able chairmanship of Mr. C. Stuart Patterson of Philadelphia.

The joint resolution offered by the three New York commercial bodies, of which printed copies were distributed among the members of the conference, was referred to a Committee on Resolutions of eleven, of which Mr. Warburg of your delegation was made chairman and Messrs. Ring and Sachs members. This committee examined the various resolutions offered by commercial bodies or their delegates, and it may be interesting to state that eight of the twelve bodies which had expressed views were in favor of a central banking organization.

In addition to the delegations of the Chamber of Commerce of the State of New York, the Merchants' Association of New York, and the New York Produce Exchange, the bodies offering resolutions in favor of a central banking organization, were the Board of Trade of Philadelphia, the Baltimore Board of Trade, Baltimore, Md., the Chamber of Commerce of Spokane, Wash., the Board of Trade of Scranton, Pa., and the Board of Trade of Wilmington, Del. It is a great satisfaction for your committee to report that the resolutions offered by the delegates of the three New York commercial bodies were adopted by the Committee on Resolutions with only slight amendments and with only one dissenting voice, and offered to the convention as the joint resolution of the conference. . . . (The preamble and resolutions are printed in full on pages 63 to 65, Chapter IV.)

On the day preceding the meeting of the conference, Senator Aldrich published his plan for banking and currency reform, and copies thereof were in the hands of the members of the conference. The general provisions of the plan were explained in an instructive address by Assistant Secretary of the Treasury, A. Piatt Andrew.

Your delegates are greatly pleased to report that this plan, barring a few comparatively unimportant details, complied fully with the principles established in the foregoing resolution. The subsequent resolutions endorsing the broad principles of the Aldrich Plan without committing the conference to every detail of the same, and advocating the creation of a Business Men's League to assist in a campaign of propaganda and education, were unanimously adopted by the Committee on Resolutions.

These resolutions read as follows:

Resolved, That there be appointed by the Chairman of this conference a committee of seven, to organize a Business Men's Monetary Reform League which shall have its main office in Chicago with branches in the various centers of the United States where local committees shall constitute the management. The object of this League shall be to carry on an active campaign of education and propaganda for monetary reform, on the principles, without endorsing every detail, of a reserve association with branches in the business centers of the country as outlined in Senator Aldrich's plan.

Resolved, That the delegations here present be requested to use their influence in the commercial bodies they represent to gain the active coöperation of these bodies and of their individual members in the work of the League as defined.

Resolved, That the Business Men's Monetary Reform League be requested when organized to provide for a committee on propaganda and education, and also for a committee on legislation whose duty it shall be to further monetary legislation on the principles adopted by the League.

Resolved, Furthermore, that the committee on organization be requested to bring about the coöperation, and if possible, a consolidation between this League and the National Currency League already organized about a year ago by the Merchants' Association of New York.

All of these resolutions were offered to the conference at its afternoon session, by the Chairman of the Committee on Resolutions, and after instructive debate they were carried by an overwhelming majority.

The conference was addressed at the afternoon session by the Hon. Edward B. Vreeland, Vice Chairman of the National Monetary Commission, while at the banquet, following the conference, there were addresses delivered by the Secretary of the Treasury, the Hon. Franklin MacVeagh, and the Hon. John W. Weeks, member of the National Monetary Commission.

All of these gentlemen made strong presentations of the weakness of our present financial system and they all unequivocally endorsed, in the strongest terms, the principles of the Aldrich Plan. They all, furthermore, voiced the sentiment that if under present political conditions this most desirable reform was to be secured it

could only be achieved by a strong wave of public opinion, which would force Congress to pass this legislation without consideration of party lines. It was strongly expressed that this reform was not a bankers' question, but a problem most vital to everyone, and Secretary McVeagh, in particular, pointed out the hardships that our present system inflicts upon the classes of medium and small means and that these would derive the preponderant benefit and protection from the establishment of a central organization, as planned by Senator Aldrich.

While it was generally admitted that Senator Aldrich's scheme was not complete in its present form and that many details might be a matter of further discussion, there was unanimity that the underlying principles of the plan were sound and that it contained the basis for the long sought for remedy of the defects of our present financial system.

The plan providing for the creation of a Business Men's Monetary Reform League met with emphatic approval on all sides.

It was generally expressed that the voice of the important commercial bodies would carry the greatest weight throughout the country and that by organizing and carrying on an active campaign of education and propaganda these commercial bodies could be more effectively instrumental in securing the success of the needed legislation than any other organizations. Incidentally, the legislative committee to be formed by this League could render great service in formulating the law, and the more important the League, the stronger would become the influence of its legislative committee.

In organizing this Business Men's Monetary Reform League, it was planned to divide the country into zones of operation and to organize for each section of the country a special committee to do the active work—a central committee, having its seat at Chicago, to lead the general plan of campaign and of organization.

The Merchants' Association having already started a similar organization about a year ago, and having united with itself a large number of important commercial bodies, it was resolved that steps should be taken to bring about a coöperation and, if possible, a consolidation, so as to have all the important commercial bodies of the country united in this effort.

Your delegates, in presenting this report, and in fulfilment of the mission with which they have been charged by the conference, beg to ask of this Chamber that it coöperate in the organization of this Business Men's Monetary Reform League and that it give its active support to this most important work to be done for the benefit of the whole country.

Respectfully submitted,

Paul M. Warburg
Welding Ring
Algernon S. Frissell
Samuel Sachs
Maurice L. Muhlemann
} Delegates to Monetary Conference

New York, January 30th, 1911

APPENDIX FIVE

EXCERPTS FROM ADDRESS OF HON. NELSON W. ALDRICH, CHAIRMAN OF THE NATIONAL MONETARY COMMISSION, BEFORE THE ANNUAL CONVENTION OF THE AMERICAN BANKERS ASSOCIATION, AT NEW ORLEANS, NOVEMBER 21, 1911

. . . The failures of our monetary system can be attributed in part (1) to our inability to enforce that effective coöperation of banks which is necessary to protect public and private interests in times of stress or crises; (2) to the limitations and restrictions imposed by antiquated laws with reference to the treatment of reserves; and (3) to a defective, inelastic, and unscientific system of note issue. . . .

. . . I ought to say, perhaps, in this connection that even following 1900, until we were suddenly awakened by the events of 1907, there was no clear idea on the part of bankers or business men generally of the character of the real defects of our system. When the Commission was appointed and we undertook this great work, there was little reliable information available either as to the defects of our own system or as to the methods and practices of other countries. I could count upon the fingers of one hand the gentlemen, whose names are familiar to you, who had any accurate knowledge of the real, practical methods and practices by which the banking and monetary systems of Europe were carried on. We were obliged to enter upon what was in effect a new field of exploration, and I venture to say that it is only within the last two or three years that our people have become thoroughly aroused to the importance of this great question. Within that time we have made great advances in a very gratifying way toward a consensus of public opinion, not only as to the character of the evils from which we have suffered, but as to the general character of the remedies which must be applied.

I shall discuss briefly some of the salient features of the plan to remedy these defects through the organization of a National Reserve Association. It is proposed to organize the banks of the country into local associations, and these into district associations, each with distinctive functions and each with local self-government, and to organize all district associations into the National Reserve Association.

The organization proposed is not a bank, but a *coöperative union* of all the banks of the country for definite purposes and with very limited and clearly defined functions. It is, in effect, an extension, *an evolution of the clearing-house plan modified* to meet the needs and requirements of an entire people. The plan or organization includes positive provisions:

First, to maintain the integrity and independence of existing banks, state and national. The new organization is outside of and in addition to the existing system. As it is not a bank, it is not in any sense a competitor for the business of existing banks. In its ownership and domestic business it is confined strictly to banks and the government.

Second, it provides clearly the equality of privileges and advantages for all banks, great and small, wherever located.

Third, it provides equality in rates of discount, or rediscount, for all banks, and these rates are to be uniform throughout the country. This, it is believed, will insure steadiness and reasonableness of rates everywhere. . . .

. . . Fourth, this organization is of a form and character that will effectually prevent the control of its operations by political influence, local or national. This organization is analogous to that of clearing houses, and I have never known politics or differences of opinion growing out of the size of a bank or its location to enter into the selection of the management of a clearing-house association . . . no plan, however wise may be its provisions, has any chance of adoption, and this great question can never be successfully solved, unless it can be kept out of politics. . . .

. . . The fear is expressed in some quarters that this selection of the governor by the President and the provisions making the Secretary of the Treasury, the Secretary of Commerce and Labor, and the Comptroller of the Currency *ex officio* members of the

board of directors of the Reserve Association, might lead to an attempt to control the organization for political purposes. I believe that the participation of these officials in the management of the institution to the limited extent prescribed is necessary to secure a proper recognition of the vital interest which the public has in the management of the Association. . . .

. . . Fifth, to prevent beyond question the possibility of its control by any corporation or combination of corporations, banks or otherwise, by any individual or combination of individuals in Wall Street or elsewhere, for selfish or sinister purposes, it is proposed to take every precaution and to adopt every safeguard. No provision of a plan to reconstruct our monetary system is of more vital importance than this. . . . we are now staking the safety of all of our banking resources on the patriotic character and business ability of bank managers in New York whose hands are tied in emergencies by the restrictions of a defective system and unwise legislation. The responsibilities of continuing this control are too enormous, the risks of failure are too great, for this condition to be tolerated long. In my judgment the only effective remedy for this dangerous condition will be found in the organization by the national government of an association of a character similar to that suggested, with branches which will be relief centers at various points throughout the country, each with local self government, but through which the cash resources of all the banks will be available for the support of any in case of trouble. The country banks now depend for assistance upon their correspondents in reserve cities or central reserve cities. The reserve cities, the reserve agents of the country banks, and individual banks generally depend upon the banks of New York. This is naturally so, because New York, with her vast accumulations of capital, is the most important financial center in the country. When any serious financial disturbance occurs in New York—like the bank suspensions in 1907—and New York fails to respond to the drafts from other sections, the country suspends. This dangerous condition of dependence will continue until we have a thorough reorganization of our banking system. Every financial institution in the United States is in peril whenever confidence is destroyed in the strength of the New York banks or in the wisdom of their

Now the organization which we propose has for its first and its prime purpose to place the banking business of the country, through local associations, in such a condition that there can be no general suspension of the banking institutions of the country and no general suspension of their credit functions. . . .

. . . Sixth, the dominating principle is coöperation and not centralization. We were satisfied that we could not adopt or adapt to our use an organization like the central banks of Europe or the second Bank of the United States.

We cannot afford to overlook the prejudices of the past or the present. One of the principal objections to the second Bank of the United States was the charge of personal and political favoritism to individuals in its management. We must afford no opportunity for a repetition of transactions of this character, and the new organization must, therefore, do business with the banks alone; it must be their agent, not generally, but for certain specific and well defined purposes.

Among the provisions of the plan intended to remedy defects and cure existing evils are the following:

1. To insure the maintenance of adequate reserves by the association and its members, with such provisions for discounts and note issues as shall enable the organization to respond promptly at all times to normal or unusual demands for credit or currency without danger of undue expansion or inflation.

2. To provide for concentration of the cash reserves of all the banks to be used for the assistance and support of any, under assured decentralization of control. Scattered reserves have been found useless in times of pressure. Deposit balances in the Reserve Association are to be counted as legal reserves.

3. To authorize the Association to rediscount, through its district branches under local control, commercial paper of a definite character for individual banks, to be used in replenishing their reserves.

4. To give to individual banks the facilities for an increase of their reserves and loaning power, which will enable them to adopt the policy which has been universally effective in other countries of allaying excitement, creating confidence, and preventing panics by prompt payment of all demand obligations as presented, and

at the same time granting a liberal extension of credit to all deserving customers in times of uncertainty and distrust. . . .

. . . In this country we have had but little serious discussion with reference to the proper character and extent of bank reserves, but all must agree that the manner of distribution makes them useless when needed. When we consider that the cash reserves of the banks are necessarily divided into 25,000 widely scattered portions, it is not surprising that they should fail of their purpose and prove useless in time of trouble. Instead of being concentrated, as they are in all other countries, for the effective protection and benefit of any, they are rendered by this distribution ineffective and useless to all. In other countries reserves are regulated, both as to character and extent, by the judgment and custom of managers of banks and not by legislative provisions. . . .

. . . We propose to remedy the defects to which I have alluded by providing that the balance of any bank with the Reserve Association shall be counted as a part of its legal reserve. The Reserve Association may through its branches rediscount commercial paper for individual banks whenever it becomes necessary to maintain their balances and to protect and replenish their reserves. Commercial paper available for this purpose, as defined by the plan, includes all notes and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, but not for carrying stocks, bonds, or other investment securities. . . .

. . . The plan provides not only for a concentration and mobilization of cash reserves, but for a decentralization of control by means of the powers over distribution granted to local and district associations. . . .

5. To grant the power for further note issues to this coöperative association of all the banks, an authority which is now vested in national banks scattered throughout the country. . . .

6. We provide for giving authority to the Reserve Association to fix rates for rediscounts, which must be uniform throughout the country.

7. We give to the Reserve Association power to protect its own reserves, and thus enable it at all times to perform its most important function, that of sustaining the credit of communities and the country. For this purpose the Association is required to keep its

assets always in liquid form, and all its rediscounts and investments must be in short-time paper or securities. To enable the Association to strengthen its own reserves it may, first, attract gold from other countries by an advance in the discount rate. In other countries this method of attracting gold and of replenishing the gold supplies of the country has been always found effective. Second, it can purchase and borrow gold and give security for its loans. Third, it is authorized to buy and sell, either in the United States through its subscribing banks, or in foreign countries through foreign banks or correspondents or its own agencies, bills of exchange payable in any of the great commercial countries. A large portfolio of short-time foreign bills has been found elsewhere the most effective means for increasing the gold supply of countries and preventing its exportation in critical times. . . .

8. Believing that it is of great importance to establish a wider discount market in this country, the plan prescribes a standard of commercial paper, which is made available for rediscount at the branches of the Reserve Association; second, it allows national banks, to the extent of one-half their capital, to accept properly secured drafts drawn upon them—drawn, perhaps, with documents attached, against cotton, wheat, or other products in transit or in warehouse; third, it authorizes the National Reserve Association, as I have already stated, to buy and sell in this country and abroad bills of exchange drawn on foreign countries, based on transactions in American products, or to pay for our purchases abroad. It gives in this manner a national and international currency, a newer and wider market, to notes, acceptances, and bills of exchange based on the agricultural and other products of the United States.

9. It requires the Association to facilitate domestic exchanges by transfer of balances from one branch of the Association to another upon application. . . . The great banks of Europe make transfers of this nature to a very great extent. Great benefit will accrue to us, especially in times of excitement and uncertainty, by having one great institution, that by simply transferring a balance upon its books, can transfer funds from one section of the country to another without delay.

10. It is proposed to admit state banks and trust companies to

membership and equal privileges in the organization under provisions which coördinate the conditions of membership of all banks in the same locality with reference to the character of their reserves against demand and time deposits and with reference to the character and number of examinations and the frequency and character of reports of condition. The treatment of time deposits is believed to be equitable to banks of all classes. . . .

11. We propose to give national banks increased privileges. There has been a feeling that in the competition for business throughout the country state banks and trust companies, especially in recent years, have had an advantage over national banks. . . . I believe it is fair to both classes of institutions that so far as we can do so by national legislation—and we are, of course, confined to very narrow limits in this respect—we ought to give to national banks, state banks, and trust companies an equality of privileges and advantages.

We propose also—and this is in answer to persistent demands from various sections of the country, and especially from the Northwest—to give to the national banks the right to establish savings departments, and to loan money on real estate, under proper regulations and control. . . .

12. The plan authorizes the organization of banks in foreign countries to assist in the extension of our international trade. . . . As an illustration of the helplessness of the banks under this defective system, I will refer briefly to the manner in which our banks are obliged to treat their surplus funds in the summer months and at other times when there is no local demand. I am not now discussing reserve moneys or the money deposited with reserve agents. The surplus I have referred to was probably sent to New York, perhaps through New Orleans or Kansas City or Chicago, but it would reach New York in the end. What did the New York bankers do with it? They probably were obliged to loan it on call on stock-exchange collateral. There would be nothing else that they could do with it. They loan it at the market rate, inducing at times, as we all know, dangerous speculative conditions. When the banks in the country need their money they are liable to be told that conditions are such that they will have to wait. In times like 1907 they could not get it at all by any process.

If the withdrawals are made, a reduction in reserves follows and the necessary calling of loans is liable to affect rates for money and create more or less disturbance in the market.

Banks do not dare now to buy bills drawn against foreign shipments of the character which I have described, first, because they have no knowledge of the responsibility of the parties making the drafts, and, second, because of the fear that at the time when they might need the money there would be no demand or market for paper of that class.

To cure the banks of a bad habit we propose a plan by which instead of depositing their money at 2 per cent in Wall Street to be used for speculative purposes they can safely invest it at, say, 3 to 4 per cent in standard notes or bills of exchange representing the industries or the products of the United States. . . . and they will have in their portfolios commercial paper created for legitimate purposes, which they can take to the District Association and have transformed into cash or a cash credit at any hour of any business day of the year.

And what I say about foreign bills is largely true of domestic bills of the character of the acceptances authorized by the plan. . . .

. . . I ask you if it is not worth while to take the banking institutions of the United States out of a condition of dependent helplessness and place them, where they belong, in a class with the best and strongest banking institutions in the world? There is not a particle of reason why prime sterling bills should forever remain the highest form of credit. We ought to make New York and New Orleans and Chicago financial centers of equal importance with any in Europe. We ought to make a documentary bill drawn by a producer here in Louisiana or anywhere in the United States, drawn in dollars and cents, equal in currency and value to any drawn in pounds, shillings, and pence.

APPENDIX SIX

EDITORIAL PUBLISHED IN *THE NEW YORK TIMES* MARCH 4, 1911

Yesterday was the centennial of the end of the first experiment of the United States in central banking, and Mr. J. Howard Cowperthwait thought that was a suitable occasion to oppose the motion of Mr. Paul Warburg that the Chamber of Commerce should adopt the report of its delegates to the Washington conference in approval of the Central Reserve Association. Yet Mr. Cowperthwait proceeded to say that there was nothing the matter with the first Bank of the United States as a bank, nor yet with the second Bank. Both became "political footballs," and from that day to this "the spectre of Andrew Jackson has stood at the portals of Congress to destroy any attempt to centralize banking." Mr. Cowperthwait is afraid that this experience is about to be repeated. He declared that he had reasons to believe that the Monetary Commission is not well disposed toward the suggestion of Senator Aldrich and, as he is a Republican, the Democratic Congress will not approve his work even if the Commission should. Besides the country is not ready for the question, and will not be until it has read the library which the Monetary Commission has compiled. Mr. Cowperthwait's idea was that Senator Aldrich's report was a question between himself and his colleagues, and should be left so until the Commission has taken some action formally.

The expediency of waiting until the country has digested the Monetary Commission's collection of monographs is sufficiently negatived by an incident which occurred during the Chamber's debate. It was proposed to ask a show of hands as to how many present had read the report of the Chamber's committee, not to mention either Senator Aldrich's suggestion or the Commission's library, and it was thought prudent not to risk the show. If the Chamber of Commerce will not read the reports of its own members,

written with distinguished ability and engaging style, what possible hope is there that the country will read the general literature of the subject? And if the country will not inform itself, with the shame and miseries of 1907 so recent in memory, what should be the alternative, indefinite delay or renewed vigor on the part of those who have convictions on the subject.

It is agreeable to record that the Chamber decided against delay, and adopted Mr. Warburg's report. He well said that there are no Republican or Democratic depositors or borrowers, and that the misfortunes which are still poignant in the memories of many were distributed with entire impartiality. Senator Aldrich's proposal is simply a statement of principles, with a rough draft of one way of applying them to the necessities of our case. Its strength lies largely in its impersonal character and in its adoption of what is settled in finance rather than in any ingenious invention of original character. The partisan who is capable of taking a partisan view of such a matter is capable of demanding an American arithmetic. It is a strictly American system of banking which we wish to rid ourselves of and adopt instead essentials which are approved among all commercial nations, even though the unessentials and forms may differ. Mr. Muhlemann, Mr. Sachs, and others made plain that Mr. Cowperthwait had taken the best course to precipitate the evil which he feared, and they were able to carry the Chamber with them. The result of the interesting proceedings is more encouraging than the disclosure of how shallow an impression was made by the events of 1907 among those who might have been assumed to have been in a state of soothing indignation that the continuance of conditions so threatening to orderly business should be endured a moment longer than is necessary.

APPENDIX SEVEN

QUOTATIONS FROM A PAMPHLET OF THE NATIONAL CITIZENS' LEAGUE FOR THE PROMOTION OF A SOUND BANKING SYSTEM

The Origin of the League

As a result of the panic of 1907, the country became concerned about the commercial safety of its future. This anxiety so pressed upon Congress that the Aldrich-Vreeland Currency Bill of 1908 was passed. This bill was recognized purely as a temporary measure, and the National Monetary Commission was created to investigate the problem of banking reform.

At the annual meeting of the National Board of Trade, held in Washington on January 25th, 26th, and 27th, 1910, the following resolutions were unanimously adopted:

> *Whereas*, we assume that a plan for the revision of our currency system will be formulated after the National Monetary Commission has made its final report: and
>
> *Whereas*, a revision of our currency system upon a permanently sound and scientific basis is of vital importance to all interests and should be accomplished as soon as practicable:
>
> *Resolved*, That the National Board of Trade favors the adoption of a currency system which will be based upon the following fundamental principles and insure the following results:
>
> First—Be absolutely fair to all interests and to all localities:
>
> Second—Insure at all times an adequate supply of properly safeguarded currency:
>
> Third—The volume of said currency to automatically expand and contract in response to the normal demands of the manufacturing, commercial, agricultural, and other legitimate interests of the country:
>
> Fourth—Said system to be absolutely free from domination or control by political or any other favored interests:

Resolved, That the National Board of Trade calls upon all its constituent bodies to carefully study the fundamental principles of banking and currency, in order to intelligently aid the enactment of such legislation as will best conserve the interests of the entire country.

The National Board of Trade decided to devote one day in connection with its Annual Meeting in 1911 to a Business Men's Monetary Conference. January 18th was set aside as "Monetary Day." Two hundred selected commercial bodies were asked to appoint special committees to make a careful study of the banking question. Each organization was requested to submit its conclusions and recommendations to the National Board of Trade at least one month before the meeting, and to send a representative to the meeting, to be held in Washington beginning January 17th, 1911. The invitation met with a hearty response on the part of the commercial organizations throughout the country, and a large number of delegates participated in the Conference.

On January 17th—the day preceding the Conference—the tentative plan of the National Monetary Commission for banking reform was published and copies were already in the hands of the delegates. Many of the details failed to find acceptance, but it was recognized that it contained essential features which would give us a constructive banking and credit system of the highest value to the country.

The Business Men's Monetary Conference adopted resolutions which ultimately led to the creation of the National Citizens' League. By these resolutions, the chairman of the Conference was authorized to appoint a committee of seven to organize a "Business Men's Monetary Reform League," with headquarters in Chicago and branches in the principal centers of the country, whose object should be to conduct a comprehensive campaign of education in behalf of some kind of a National Reserve Association. It was agreed that the delegates to the Conference should endeavor to enlist the active aid of the commercial bodies they represented.

Acting on the authority of these resolutions, a committee was created which held a conference in Chicago, April 26th, 1911. It was agreed by this committee that the responsibility of creating a national organization should be left with the business men of

Chicago, who should conduct a nation-wide campaign from their city. The problem was laid before a number of prominent and representative Chicago business men who, after careful deliberation, agreed to accept as a duty and privilege the responsibility of conducting the campaign from this center. Several meetings followed and a general plan of campaign was mapped out.

The new movement was initiated by the Chicago Association of Commerce. A joint meeting of the Board of Directors and the Executive Committee of the Association was held on May 29th, and took action by passing the following resolution:

> *Resolved*, That the Chicago Association of Commerce, recognizing the distressing effects of panics on trade, capital, and labor, the consequent need of a sound banking system in the interest of all the people in the country, and the suggestion made for the creation of a National Reserve Association, hereby requests John G. Shedd, Marvin Hughitt, Graham Taylor, Harry A. Wheeler, B. E. Sunny, Cyrus H. McCormick, Julius Rosenwald, Charles H. Wacker, Frederic A. Delano, John Barton Payne, A. C. Bartlett, A. A. Sprague, J. Laurence Laughlin, John V. Farwell, Clyde M. Carr, Fred W. Upham, F. H. Armstrong, and Joseph Basch to form a National Citizens' League, the object of which shall be to give organized expression to the growing public sentiment in favor of, and to aid in, securing the legislation necessary to insure an improved banking system for the United States of America.

The Citizens' League is national in every respect: and the Chicago Association of Commerce only accepted a responsibility imposed upon it by the other commercial bodies of the nation to take the initiative in the conduct of a campaign to which their support had been pledged. The only part taken by the Chicago Association, as such, was to launch the new League. This done, it surrendered all control into the hands of the Board of Directors of the League.

The organization was named "The National Citizens' League for the Promotion of a Sound Banking System," and a certificate of incorporation was granted by the Secretary of State under date of June 6th, 1911. Article 2 of the certificate of incorporation is as follows:

> The object for which it is formed is to give organized expression to the growing public sentiment in favor of, and to carry on a campaign of education for, an improved banking system for the United States of America.

It remains for the National Monetary Commission to make its final report in the form of a bill. It is understood that the National Citizens' League, business organizations, labor unions, and all others wishing to express views on the National Reserve Association Plan of banking and currency reform, will be given an opportunity to present their case. Hearings will begin on October 15th, after which the Commission will prepare a final report to Congress. Congress has demanded a report on January 8th and set March 31st, as the limit of life allowed the Commission.

The National Citizens' League for the Promotion of a Sound Banking System proposes to represent the people. The League as yet has no legislative proposal of its own. It invites suggestions from any source. But it presents the following objects to be attained, which it hopes to have incorporated into law:

1. Coöperation, not dominant centralization, of all banks by an evolution out of our clearing-house experience.
2. Protection of the credit system of the country from the domination of any group of financial or political interests.
3. Independence of the individual banks, national or state, and uniform treatment in discounts and rates to all banks, large or small.
4. Provision for making liquid the sound commercial paper of all the banks, either in the form of credits or bank notes redeemable in gold or lawful money.
5. Elasticity of currency and credit in times of seasonal demands and stringencies, with full protection against over-expansion.
6. Legalization of acceptances, or time bills of exchange, in order to create a discount market at home and abroad.
7. The organization of better banking facilities with other countries, to aid in the extension of our foreign trade.

The League asks the nation to consider carefully and in an open-minded way the platform outlined above, and invites the co-operation of all classes in the interests of much-needed banking

reform. This coöperation can be effectively given by becoming a member of the League.

The fee for membership in the League is one dollar. The proceeds of this membership fee will be devoted exclusively towards paying the expenses of the campaign. A section of the League is formed, or will be formed, in each State. Your remittance may be made to the Treasurer of your State Section, or to

THE TREASURER
National Citizens' League
223 West Jackson Boulevard
Chicago, Ill.

APPENDIX EIGHT

LETTER TO HON. CARTER GLASS FROM MR. VICTOR MORAWETZ

April 5th, 1927

Hon. Carter Glass,
Lynchburg, Virginia

Dear Sir:

Because of your prominent public position, I wish to correct a misapprehension on your part. Articles published by you in the *New York Evening Post* indicate that you are of the impression that I have claimed authorship of some part of the Federal Reserve Bank Act. This is not the case. I have never asserted that I took any part in the framing of the Act or in securing its passage through Congress. So far as I can remember, I never saw a draft of the bill until it had passed the House of Representatives.

However, it is a fact, established by contemporary publications, that I publicly proposed the adoption of the principle of regional reserve banks long before the regional reserve bank plan was considered in Congress. When reform of our banking system had become an issue of widespread public interest and the Aldrich Committee was appointed, I discussed the subject with Senator Aldrich and with leading bankers, and in 1909 I published a small book on the Banking Problem. I consistently and strongly opposed the plan of establishing a central bank and I suggested that to secure the necessary concentration of bank reserves the country should be divided into sections and that a properly constituted reserve bank should be created for each section, the national banks in each section furnishing the capital and becoming the shareholders of the reserve bank for their section. So far as I am aware, this was the first suggestion of the creation of regional reserve banks instead of a single central bank.

I elaborated this plan in an article published in January, 1911, in the *Proceedings of the Academy of Political Science* in the City

of New York. (Vol. 1, No. 2, page 343.) I am sending you under separate cover a reprint of this article. You will observe that it is divided into three heads, namely, (1) A statement of the defects of the then existing system, (2) A statement of the objections to the central bank plan, and (3) A proposal to divide the country into sections and to create a reserve bank in each section.

At this time I had become convinced that in my book on the Banking Problem I had attached too much importance to the issue of bank notes as a means of maintaining sound banking conditions and that concentration of the bank reserves in properly organized sectional reserve banks was far more important. My recognition of this fact was due principally to discussions with that exceptionally able, learned, and experienced banker, Mr. Paul Warburg, who, however, at that time, was opposed to my proposal to establish sectional reserve banks and insisted that the only satisfactory way of obtaining the desired concentration of bank reserves was by creating a single central bank with branches.

In the autumn of 1911 the article above referred to was reprinted in pamphlet form with a few pages of additional matter and copies were sent by me to the members of the Banking and Currency Committees of the Senate and of the House of Representatives. After President Wilson's election, but before his inauguration, a copy of this pamphlet was placed in his hands, and I have letters from Mr. Thomas D. Jones of Chicago, at whose house President Wilson stopped, and from Professor J. Laurence Laughlin of Chicago University stating that Mr. Wilson said to them that he approved of the general plan which I outlined.

At this time nearly all the leading bankers in the country favored the adoption of the central bank plan and my principal endeavor was to convince the advocates of that plan that a regional reserve bank plan was preferable. When I appeared before the Committee of the House of Representatives in January, 1913, I had become satisfied that the central bank plan was politically dead and my principal endeavor was to point out that the main problem was not a currency problem but a banking problem and that the prime necessity was regional concentration of the bank reserves. When I appeared before the Senate Committee on Banking and Currency on October 20th and 21st, 1913, I stated that the bill embodied

the substance of the plan which I had advocated for years and my discussion of the bill related to the provisions for carrying into effect the principle of regional reserve banks. (Proceedings of Senate Committee, pages 2615 to 2700.)

I have always recognized that unlimited credit is due to President Wilson and his able lieutenants, including yourself, for framing and securing the adoption of the Federal Reserve Bank Act. It required extraordinary vision, courage, and political ability on the part of the President to secure the adoption of that plan under the then existing conditions. I regard the adoption of the Federal Reserve Bank Plan as the greatest political accomplishment of President Wilson's administration.

Until the publication of your articles in the *Evening Post* I claimed no credit for proposing in my printed publications in 1909 and 1911 the establishment of regional reserve banks instead of a single central bank. My proposal to establish regional reserve banks was merely an adaptation to the conditions existing in the United States of the principle of the central bank system which for many years prevailed in every civilized country except the United States. As pointed out in my article, the United States is nearly as big as all of Europe and the creation of a single central bank for the whole of the United States would have been equivalent to the creation of a single central bank for the whole of Europe. Each of the regional reserve banks performs in effect the functions of a central bank for the region in which it is established. No doubt this adaptation of the underlying principle of central banks would have occurred to many of the able bankers who supported the Aldrich Plan if they had not already been wedded to that plan.

However, when I heard that a controversy had arisen as to the authorship of the Federal Reserve Bank Plan and that you were about to publish in the *Evening Post* a series of articles controverting some of the statements in Professor Seymour's book, I wrote to Colonel House on January 5th, calling his attention to my publications in 1909 and 1911 and stating that my pamphlet proposing divisional reserve banks instead of a single central bank had been considered by President Wilson and approved by him before his inauguration, as stated in the letter of Professor Laughlin which I quoted. I also stated that the President had

remarked to a friend of mine when the Federal Reserve Bank Bill was before the Committee of the House of Representatives that I ought to be satisfied with the bill as it was my plan. My letter to Colonel House was not written for publication, and by an oversight I referred to my appearance before the Committee of the House of Representatives in January, 1913, instead of my appearance before the Senate Committee in October of that year, though I sent with the letter a printed copy of my testimony before the Senate Committee on October 20th and 21st. When this letter was recently published, you made this oversight in referring to my appearance before the Committee of the House of Representatives instead of the Senate Committee the basis of an attack in unmeasured terms upon my veracity in an article published in the *New York Evening Post.* I think this attack was unjustifiable on your part as it was obvious that I did not intend to refer to my appearance before the House Committee in January, 1913, when no bill had been drawn and Mr. Wilson was not President, but that I intended to refer to my appearance for two days before the Senate Committee in October.

In the publications above referred to I presented merely the bare outline of a plan for the creation of regional reserve banks instead of a single central bank. The details of my proposal were not worked out, but I made a suggestion designed to secure united action of the several regional banks when needed which differed materially from the provisions of the Federal Reserve Act. It was this: I proposed that the several regional reserve banks should elect a central body authorized, in conjunction with the Secretary of the Treasury, to deliver to each divisional reserve bank, upon its application, circulating notes of this bank guaranteed by all the reserve banks upon deposit of a prescribed amount in a reserve or note redemption fund, the percentage of which would be subject to increase or reduction, from time to time, by the Association with the approval of the Secretary of the Treasury. Under the Federal Reserve Act the control of note issues and reserves is in effect vested in the Federal Reserve Board in Washington. In making this proposal I was influenced by the fear that if full control of the entire system were placed in the hands of political appointees the entire system might some day be wrecked

through politics. In his interview published in the *New York Times* of January 9th, Professor Willis who at your request in 1912, prepared the first draft of the Federal Reserve Bank Bill, used the following language: "Mr. Wilson wished even stronger centralization than the draft of the bill provided. He adopted a proposal of Bryan to make the Federal Reserve Board a government body rather than simply a group of bankers. This was in order to win Bryan's support for the bill."

I am now satisfied that for political reasons the creation of the Federal Reserve Board sitting in Washington was preferable to the proposal made by me. Certainly the Federal Reserve System has worked admirably up to the present day and I am sure that it will continue to serve the country well so long as the members of the Federal Reserve Board are appointed on their merits and not for political reasons or to represent special interests.

Yours very truly,

Victor Morawetz

APPENDIX NINE

REVIEW OF THE "REPORT OF THE NATIONAL MONETARY COMMISSION" BY THE COMMITTEE ON NATIONAL AFFAIRS OF THE REPUBLICAN CLUB OF THE CITY OF NEW YORK, FEBRUARY 19, 1912

The Monetary Commission has divided its work and its report into two parts: First, a study and exposition of the defects of our present system, and second, a recommendation of a remedy.

Both parts of the report are convincing documents, written with the clear intention of submitting an argument which can be generally comprehended. This is all the more commendable since the dissemination of facts is the only way of combating a prejudice which always has played and still plays so important a part in the discussion of this problem. Your Committee suggests that every member of the Club read the full report of the Monetary Commission and influence all those to do likewise who want to form an unbiased judgment concerning the solution of this all-important question.

The main defects of our present system are the decentralization of our cash reserves, the immobilization of the commercial paper held by our banks, and the inelastic bank-note issue, based on government bonds instead of on gold and commercial paper.

At present reserves are scattered amongst more than 20,000 institutions and these accumulations of cash are called reserves only by a misnomer. A power on which to fall back, for aid in case of need, we are used to call a reserve; but the cash reserves of our banks are helplessly tied up by law and to use them in critical times by encroaching upon the legal minimum amounts to an invitation to the depositors to begin a run. As actual reserves these cash holdings are therefore useless and the mere fact that they must be kept up is, under our present inelastic system, the direct reason why our entire financial structure is resting on a mine

which may explode at any moment. For there are no means of replenishing one bank's dwindling cash reserves except by drawing upon the reserves of another and the very moment that there springs into existence any interference with the free return flow of cash into the banks, while withdrawals continue, panic and suspension must follow under a system that in critical times does not provide for any possibility of issuing additional currency or of creating available bank credits by the rediscounting of commercial paper.

Any modern banking system, with billions of demand obligations against which there are available only millions of actual cash, must periodically collapse unless it provides for the concentration of cash reserve in one central reservoir whence cash will be freely forthcoming when required, and into which it will rapidly return just because it is freely forthcoming. If we want to be safe, we must either return to the old system of using actual cash for the daily payment of any and all obligations, or if we wish to proceed on modern lines of substituting credit tokens for the use of cash and of developing to its highest possible form the system of paying by clearing of credits, we must establish a system which insures not only that cash credit will always be convertible into cash, but also that cash credit to the bank and to the depositor will be more valuable even than actual cash, because safer and cheaper to handle.

A modern banking system must reduce the temptation of hoarding by the public well-nigh to a minimum, and must make hoarding by banks an absolute impossibility, or the whole structure is unsafe.

A prerequisite for the concentration of all cash reserves, however, is a confident reliance that the central organ will be at all times strong enough to meet every legitimate demand for gold, and that the banks, on the other hand, will at all times have the means with which to obtain cash when it may be demanded from them by their depositors.

The Monetary Commission's main problem as a banking proposition may then be divided into two parts: the one, the creation of a central cash reserve, and the endowment of this association of reserves with such powers as to render it safe beyond peradventure, and the other, the creation of a system safe both for the association

and for the banks, by which the latter can rely on their ability to create cash balances with the association against which they can withdraw actual cash whenever necessary.

To these two phases of the problem there must be added a further one, not distinctly a banking proposition, but closely connected with it on account of its bearing upon the safety, and consequently, the credit of the association, which is that of providing the strongest possible protection for the association against political or financial abuse and against the possibility of control by individuals or corporations singly or combined.

These three main requirements any plan for monetary reform will have to fulfill, and in the opinion of your Committee, they have been met successfully by the bill submitted by the Monetary Commission.

A strong central reservoir is to be created, the paid-in capital of which shall be no less than $100,000,000, but which will probably be nearer $150,000,000, and which with an equal uncalled liability of the stockholders will start the National Reserve Association with a responsible capital of between $200,000,000 and $300,000,000, an amount sufficient to command the highest possible confidence at home and abroad.

This central reservoir will become the recipient of the United States Treasury's free balance, estimated at about $100,000,000, and of a substantial portion of the actual cash holdings of the national banks, state banks, and trust companies, estimated at between $400,000,000, and $600,000,000, so that the Reserve Association will start out with such stupendous strength that distrust as to its solvency, the germ of panic, may be considered as banished forever.

But a mere dead mass of gold would not assure safety unless there be coupled with it the power of using and in turn withdrawing again a certain portion of the metal. In this power of expansion and contraction, without giving any consideration to profit or loss, lies the ability of the Reserve Association to protect the nation from a dangerous plethora and consequent efflux of gold, on the one hand, and from extreme stringencies bringing about catastrophes, on the other. It is with this object in view that the Monetary Commission has endowed the National Reserve Association

with the power to buy commercial paper, both American and foreign, having no more than 90 days to run, and to invest in certain short-time government securities. These investments of the National Reserve Association would all be of such a character that either by collection at maturity or by resale the National Reserve Association would be in a position within a very short time to liquidate its holdings at home or abroad and, by its greater or lesser willingness to reinvest, to influence expansion or contraction to a degree necessary for the protection of the nation.

In order to avoid any abuse by individuals or by individual banks it has been provided that the National Reserve Association shall have dealings only with such national banks, state banks, and trust companies as shall become subscribers to the National Reserve Association (every subscribing institution taking an amount of stock equal to 20% of its capital), and the transactions that these subscribing banks may carry on with the National Reserve Association are carefully circumscribed. Subscribing banks may rediscount with the National Reserve Association commercial paper having no more than 28 days to run; they may also sell to the National Reserve Association certain foreign bills of commercial origin and American commercial paper, having more than 28 days and less than 90 days to run, but the latter only with the joint guarantee of a local association of banks, to one of which each subscribing bank must belong. The aggregate amount which each bank may rediscount without the guarantee of its local association, is limited to the capital of the rediscounting institution.

Through this machinery sufficient elasticity has been provided to enable the National Reserve Association to assist the banks in legitimately financing the seasonable requirements of the nation's commerce and trade, while the restrictions placed upon the National Reserve Association protect it from being used for any illegitimate purpose whatsoever.

On the other hand, these limitations of power protect the nation from any abuse by the management of the National Reserve Association. An additional safeguard has been provided by limiting to 5% the income to be derived from the stock of the National Reserve Association, the balance, after the creation of certain reserve funds, going to the government. This renders it so much

easier for the management of the National Reserve Association to disregard, as it should, the question of profit to be derived from its ordinary operations, and furthermore, it eliminates any inducement even indirectly to acquire control of such an association for speculative or ambitious purposes. As an investment it would not pay, as an instrument of power it would be useless, owing to the restrictions placed upon its scope and its method of operation.

In addition, a very elaborate system of organization has been worked out for the purpose of securing an administration by a board consisting of representatives from all parts of the country and from all walks of life. *A Federal System* is proposed, consisting of fifteen districts, each containing a branch, each branch electing two directors, and each bank having one vote without any consideration of the larger or smaller capital of a bank. In addition to these thirty directors, nine further members are to be elected by all the banks by a vote on a basis of capitalization; seven additional places on the board of directors will be filled by *ex officio* members, viz.: the Secretaries of the Treasury, of Agriculture, of Commerce and Labor, and the Comptroller of the Currency, and furthermore the governor and two deputy governors, making a total of forty-six directors. Further safeguards have been provided for the purpose of preventing accumulation of voting power by one bank acquiring a substantial stock interest in another subscribing institution, but to go into a detailed description of the modus of election and operation of the National Reserve Association would be to rewrite the report of the Monetary Commission. Suffice it to say that in the opinion of your Committee the plan provides for absolute safety from the danger of the much dreaded "Wall Street" control and from the danger of political abuse. If anything, the plan goes to the other extreme of so democratizing the control that the sections of lesser financial importance and the numerical majority of the smaller banks predominate to a degree which is being considered unwise by some conservative critics.

Your Committee believes that too much importance has been attached to this question of predominance on the board; it considers the present composition safe, in spite of the too liberal representation of the weaker sections and smaller banks, and it is confident that with a larger representation of the eastern States,

the administration would also be safe. Your Committee believes that whoever will be honored by the choice of his community or the entire district to act as its representative on the board of a branch or on the main board, will feel the responsibility to such a degree that no matter whether he come from Oklahoma or Oregon or New England or New York, he will not be swayed by any other consideration, but that he will do his best in conservatively administering this trust, on the safety of which will depend the solvency of the whole nation and, in particular, that of the community which he represents. Office creates men, and in this case, where it will not be the question of political, theoretical, or altruistic work, as in so many other associations, but where the question is one of the most vital and practical character, we may rely upon it that the best men in each community will be available and will be chosen. It is time that men of calm mind and judgment should quietly consider this bogey of the danger of control by the "Money Trust" of an association as planned by the Monetary Commission. To fear that the banks of the whole country should either be lured into such conspiracy or lulled into such dependency, is insulting the manhood or intelligence of the entire nation. To believe, on the other hand, that control could be gained by the brute power of money, is folly. Those who apprehend such a course disregard completely that almost a billion of dollars would have to be invested in order to acquire the necessary majority in an association, the ownership of which would not carry any adequate advantage. Moreover, these critics overlook the fact that it may be good business to buy control of an unwilling railroad or manufacturing concern which has tangible property or franchises which cannot be duplicated. An unwilling bank acquired by force is nothing but an empty shell. Its directors may go out, organize a new bank and take with them the good will and every account of the old bank. If one or two banks were controlled it might pass unnoticed, and might be good business for the controlled banks; if 51 per cent of the banks of 51 per cent of all localities were controlled, those who would organize new uncontrolled banks would secure all the business of the community. In a presidential year, with all its hysteria, it is more necessary than ever carefully to dissect arguments, which are calculated to capture the public imagination.

A study of foreign conditions proves conclusively that central banks are democratic institutions; they are the rock bottom on which the smaller banks and banking firms base their existence in their fight for independence from the gigantic oligarchy of the large European branch bank institutions. Close scrutiny of the plan of the Monetary Commission must convince every student that far from increasing the power of any Money Trust—imaginary or real—it would similarly strengthen the independence of the smaller banks by destroying their present exclusive dependence on the large banks, and by creating instead a new neutral institution which would assure aid and protection to all legitimately entitled to it under a system of local self-administration with a joint federative supervision.

Some criticism has been levelled at the power given to the board of increasing the number of branches, which provision leaves room for the possibility of upsetting the now established balance of power on the board. The Liberals fear an increase of branches in eastern States, strengthening the eastern contingent on the board, the Conservatives fear a rapid increase in the southern and western States, which would strengthen the predominance of the smaller banks and decrease the proportionate voting power of the nine members now appointed by the stock vote. This objection might be met by adding a provision safeguarding the maintenance of the present proportion of the latter class of directors to the number appointed by the branches or, in the opinion of your Committee, the problem might be solved by providing that the fifteen branches shall not be increased in number, but that they may be sub-divided, whenever necessary, into sub-branches, acting under similar management as the branches, but under the authority and responsibility of the main branch. In this way, the future requirements of the country could be met without interfering with the balance of voting power as now vested in the fifteen branches, and this question on which the main discussion seems to center, could be satisfactorily disposed of.

The plan of the Monetary Commission provides for the taking over by the National Reserve Association of the 2 per cent United States Government bonds, for the conversion of these bonds into 3 per cent bonds, for the assumption of the present national bank

note circulation by the National Reserve Association and for the creation of a new elastic note issue to be covered by these government bonds, commercial paper, and legal tender, the latter to amount to at least 30 per cent of the aggregate of all bank notes outstanding at any time. The plan provides, furthermore, that subscribing banks may count as cash their balances with the National Reserve Association and its circulating notes.

The question has been raised whether such a system would not bring about inflation. Your Committee, after careful consideration, has reached the conclusion that the *possibility* of inflation must be inherent in any elastic system.

Too stringent a limit upon elasticity must destroy its main benefit, which is the confident reliance that there will be no suspension of cash payments. If there be a point too easily reached, even in the imagination of the people, at which cash payments may stop, the mere approach of a stringency might precipitate a run for cash and a period of hoarding which, as we have shown in the beginning of this report, must prove fatal. The possibility of inflation must be there or there would not be any safe elasticity. But the guarantee against inflation lies in the constitution of the management and, more than anything else, in the restrictions placed upon the National Reserve Association as to its scope of operation. No central bank in existence is so rigidly tied down in this respect; the central banks of England, France, and Germany may deal with individuals, loan on stocks and bonds, in short they may do a general banking business, and if in spite of these much wider functions no dangerous inflation has followed in these countries, we may confidently expect that, with the rigid conditions imposed by the Monetary Commission, the National Reserve Association will be safe beyond doubt. In the opinion of your Committee the Monetary Commission has gone to the very extreme to which it may safely go without endangering the whole structure.

Your Committee believes that in one respect the plan even now goes too far. The National Reserve Association under the present plan may not sell any of its government bonds for five years and after that period only $50,000,000 per year, and then only with the approval of the Secretary of the Treasury. In the opinion of your Committee the National Reserve Association should be

permitted, with the approval of the Secretary of the Treasury, to sell more than $50,000,000, and to sell them before the expiration of five years. As a matter of practice the National Reserve Association will probably not avail itself of this right, but as a matter of principle and of foresight, the law should be so amended that the National Reserve Association will be placed in a position where, in view of the large commitment it undertakes by assuming the national bank note issue, it may be able, in case of need, without new legislation to strengthen its position by the sale of some of its United States securities. Such mere power to act would strengthen its position and thereby the general reliance in the power of the National Reserve Association, which confidence is the basis of the whole structure.

Your Committee regrets that, within the usual limits of the reports of this Club, it is impossible to dwell on all the details of the plan, such for instance as taxation of note circulation, and that it can only touch in passing upon the far-reaching effect that may be expected from a system of transferring by book entries cash balances with the National Reserve Association from the account of one subscribing bank to that of another, thus avoiding the wasteful shipment and tieing up of actual cash now constantly traveling at cross-purposes all over the country.

The greatest importance is to be attached to those provisions that will encourage and enable the banks to accept 90 days' commercial bills drawn on them. The habit of accepting and of rediscounting will bring about a gradual but phenomenal change in our banking methods. The United States will at last be enabled to finance its own foreign trade, instead of being dependent upon and tributary to Europe in this respect, and the establishment of a "discount market" in the United States will tend towards the greater stabilization of rates of interest. At the same time it will create a new avenue for foreign money, and a means of meeting gold exports by a higher discount rate, as done in Europe. But the most beneficial effect will be that, as the ultimate regulator and holder of the funds subject to call of the entire nation, the bill market will supplant the stock market; that the stock exchange will be saved in the future alike from the senseless avalanches and the disastrous, vehement withdrawals of the reserve moneys of

the entire country; that instead of having as quick assets call loans (secured by bonds and stocks), which in case of stress cannot be collected, and promissory notes, which must not be sold, the banks in the future may consider their commercial paper as a quick asset which can be sold in case of need, and that they may be sure that their normal amount of call loans will not become immobilized by general suspension.

In other words, the plan will assure the future solvency of our banks with the same degree of certainty as our present system guarantees their periodic insolvency. And it is this stability which will compensate the Wall Street banks for the loss of autocratic powers that will follow the establishment of the National Reserve Association. It is a misconception to think that banks thrive most when interest rates are excessive; statistics show that banks do best under conditions of stability. The new conditions would enable the United States to become an effective world power, financially and commercially, and new avenues will be opened in exchange for those that will be closed.

The 100 per cent call rate and the 3 per cent gold premium will sink into oblivion, as the mail coach disappeared before the railroad.

The power of the National Reserve Association to contract for loans of gold and to deal in foreign exchange will enable the United States in the future to aid other countries or to receive assistance from other nations in a similar way as has been the practice between the large central banks of Europe, particularly between the Bank of England and the Banque de France. No further elaboration of the importance of these provisions is necessary for those amongst us who still well remember the great sufferings that might have been ended, or probably entirely avoided, if in 1907 there had been in existence an American institution with which the Banque de France could have concluded such a loan of gold. It might, however, be opportune to emphasize this point for the benefit of those critics who believe that the solution of our monetary problem would best be found by creating separate reserve associations, for which some plan of mutual coöperation has been very vaguely suggested. Your Committee believes that *either a very rigid plan of coöperation will have to be worked out, in which case it would*

result in a scheme substantially the same as the National Reserve Association or, if these separate reserve associations were to remain fairly distinct units the most important advantages to be expected from the National Reserve Association would be lost.

The flow of cash into one central reservoir would be intercepted by a large number of competing organizations, the power that lies in union would be lost, and the danger of panics would remain. There would not be any concerted action as to foreign exchanges, gold exports, and gold loans. One reserve association would be dependent for assistance on the good will of another and this, as a matter of fact, would mean that the New York Reserve Association, as the most powerful one, would control the whole country.

But while the National Reserve Association may exercise a supervisory and restraining influence in the various parts of the country, a separate reserve association could stimulate speculation and create inflation in its own territory without brooking any interference and, when finally it appealed for relief to its sister reserve association, the harm would already have been done.

While the advocates of a separate reserve association plan claim that their scheme, being the more gradual, would be the more conservative one, your Committee believes that the larger plan is the safer one in every respect.

Without materially disturbing present business methods, the plan as proposed by the National Monetary Commission would carry out in a conservative way the radical transformation of our ill-fated system into a structure built upon the principles of centralized cash reserves, elastic note issue, and mobilized commercial paper as the fundamental basis of banking.

The Monetary Commission is to be congratulated upon having succeeded in achieving a careful study and unbiased discussion of this problem. Bankers individually and bankers' associations, merchants individually and merchants' associations, economists at home and abroad, have studied the plan in its earlier stages, and have assisted in bringing about its present form, which has been generally approved and endorsed by them. It is sincerely to be hoped that this dispassionate discussion and coöperation as to further suggestions may continue without making this question an object of political party strife. Democratic and Republican

depositors looked alike in the panic, and so did the workingmen thrown out of employment; chambers of commerce and bankers' associations are composed of Republicans and Democrats alike, good money and good banking are necessities of life which ought to be secured by the coöperation of all without any minor consideration of personal or political advantage.

Your Committee begs leave to recommend to the Club resolutions as follows:

Resolved, that this Club endorses the principles and the general plan contained in the report of the National Monetary Commission and believes that the passage of a law on the lines of the recommendations of the National Monetary Commission would be of the greatest benefit to all classes; and

Resolved, that this Club urges with emphasis the advisability of continuing the further unbiased and patient discussion of the problem with the view of perfecting all details of the law, after the fullest and most searching consideration; and

Resolved, that this Club believes it a matter of the highest importance and a cause of congratulation for the people of the United States that the report of the Monetary Commission has been signed by all the members of the Commission irrespective of party affiliation and that this Club strongly urges that no efforts be spared to secure for the Commission's Report in both Houses of Congress discussion and action on non-partisan lines of equally enlightened statesmanship.

Respectfully submitted,
Committee on National Affairs
HERBERT PARSONS
Chairman

Subcommittee on Banking Reform
PAUL M. WARBURG
Chairman

JAMES R. SHEFFIELD
CORNELIUS VANDERBILT
GEORGE C. WARD

APPENDIX TEN

DR. H. PARKER WILLIS'S MEMORANDUM ON SCOPE AND EFFECT OF H. R. ———TO REORGANIZE THE PRESENT BANKING AND CURRENCY SYSTEM, APRIL 2, 1913[1]

In H. R.———, prepared for introduction by Representative Glass of Virginia, it is intended to furnish a comprehensive measure for the attainment of four objects:

1. Provision of a place for rediscounting commercial paper of specified types.
2. Provision of a basis for elastic note issues properly safeguarded.
3. Refunding of outstanding two per cent bonds so as not to inflict loss upon present holders.
4. Provision of machinery for doing foreign banking business.

In order to accomplish these purposes fully it is necessary to (*a*) repeal certain portions of existing law; (*b*) rectify various conditions in the present national banking system which are in some cases only indirectly connected with the objects sought; (*c*) furnish a new class of institutions for the performance of some functions which cannot well be entrusted to existing banks, or at all events can better be performed by others and (*d*) alter the present reserve system to a very material degree.

The scope of the bill can best be understood by an analytical review of its contents, with references to sections and paragraphs. This is herewith subjoined.

Basis of Present Situation

The present banking situation in the United States rests upon the National Bank Act proper as slightly modified from time to time and upon the so-called Aldrich-Vreeland Act (act of May 30, 1908). Of these acts the latter is completely repealed (section 1) on the

[1] Willis, H. P., *The Federal Reserve System*, pp. 170 ff.

ground that it has never become operative, probably will not become operative except under extreme stress, and was never satisfactory. The National Bank Act itself is modified in numerous essential particulars which will be pointed out from time to time in this memorandum. In a separate measure a general revision of the administrative provisions of the National Bank Act is also provided.

New Class of Banks

Fundamental to the idea of the bill is the creation of a new class of banks (section 2), to be known as National Reserve Banks. The chief points about these banks are as follows:

1. Number to be 20 with possible increase later as provided. (Section 2.)

2. Ownership to be in the hands of the National Banks of the 20 districts in which the banks are situated. (Section 2.)

3. Capitalization to be 20 per cent of the capital of the stockholding banks, one-half paid in and one-half subject to call. (Section 2.)

4. Business to be as follows:

(*a*) Rediscounting of paper presented by stockholding banks and by other banks under specified conditions, provided such paper grows out of actual agricultural, commercial or industrial transactions and does not run more than a specified number of days. (Section 14.)

(*b*) Buying and selling Government securities, gold and silver bullion and foreign coin, foreign exchange. (Section 16 and 17.)

(*c*) Government fiscal operations. (Section 21.)

Issue of Notes

The bill provides for the maintenance of existing bank notes outstanding so long as their present issuers want to keep them out, and also calls for the establishment of a note issue on a new basis to be put out by the National Reserve Banks. Provision is, however, made for retiring the present National Bank notes at the discretion of their issuers. This plan comprises the following points:

1. Every National Bank would be allowed to continue its note issue exactly as at present. (Section 26.)

2. It would not, however, be allowed to increase the issue beyond the point at which it stood when the law was passed. (Section 26.)

3. No newly organized bank would be required to purchase Government bonds, hence no new bank would have any note issues. (Section 26.)

4. Whenever an existing bank retired any of its notes and withdrew its bonds it would lose the right to put out further issues of notes above the amount to which its issue was thus reduced. (Section 26.)

5. National Reserve Banks would be allowed to issue notes secured in the same way as their other obligations to an amount equal to twice the par value of their capital stock. They would also be allowed to issue additional notes if they desired, equal to the amount of notes withdrawn by the individual banks which might from time to time surrender their note issue privilege in part or in whole. (Sections 23 and 26.)

Disposal of U. S. Bonds

Recognizing (*a*) that the present 2 per cent bonds were sold to the banks on the basis of a pledge that they might continue to be used as a basis for circulation, and that therefore the Government is morally bound to maintain their value in a corresponding degree; (*b*) and that it is desirable to retire the bonds now held behind bank notes and put in their place bonds whose value is sustained solely by their income-paying power, it is provided that

1. Banks now holding the bonds may offer these bonds for redemption or conversion into 3 per cent bonds at a rate not to exceed one-tenth of their holdings each year. (Section 26.) This would mean that a maximum of about $65,000,000 a year could theoretically be converted, and the evidence is that that sum would be absorbed without difficulty by investors each year.

2. At the end of ten years other holders of bonds would be allowed to convert them into 3s. (Section 26.)

3. As a result of these changes the Government would be obliged to increase its interest charge the first year of the new arrangement by an amount not greater than one per cent on $65,000,000, or $650,000, while the second year a like addition would be made and

so on, until at the end of ten years a possible maximum addition of $7,300,000 in interest charges would probably have been assumed.

Protection of Notes

Fully admitting the necessity of an absolute protection of note issues, the bill seeks to safeguard those for which it provides as follows:

1. National Bank notes are safeguarded at every point by exactly the same elements of protection which exist to-day, none of these being diminished in the slightest degree.

2. Notes issued by National Reserve Banks are protected by a large gold reserve, by constant close Government supervision, and by immediate and prompt redemption. Stringent provisions are made against counting any of these notes as a part of bank reserves, thus insuring their speedy return to the point of origin. (Sections 30, 31, etc.)

3. All notes are made receivable by the Government and are to be received by every bank in the system on deposit at par, without exchange. (Section 23.)

4. Uniformity in the currency is obtained by making the National Reserve notes identical in appearance and wording with the National bank notes. (Section 23.)

5. Power to oversee and control the issue of notes is placed in the hands of a supervisory board. (Sections 13, etc.)

Government Control

Overseeing the whole system is created a so-called Federal Reserve Board (Section 13) with the following organization and functions:

1. Board to consist of representatives of (*a*) national reserve banks (*b*) bank stockholders (*c*) the government itself. (Section 10.)

2. Actual working body to be an executive committee of this Board consisting of Secretary of the Treasury, Comptroller of the Currency, and Attorney General, with four members of the Federal Reserve Board chosen by the latter. (Section 11.)

3. Board and executive committee as thus made up to have power to deposit Government funds in National Reserve banks,

to fix rates of rediscount in such banks, to compel any National Reserve Bank to rediscount the paper of any other, and to examine the banks of the system. (Section 13.)

Structure of System

The effort has been made to "popularize" the control of the whole system of banking thus built up while at the same time preserving a sufficient amount of centralization, controlled by Governmental agency, to insure that the whole system shall be responsive to legitimate public demands. The bill is based on the belief that no one should participate in the control of the system unless he is either financially interested himself or chosen by those who are, save insofar as the Government steps in to exert the authority of the whole community. With this in mind the system has been developed as follows:

1. Organization, powers and functions of National Banks are left as at present.

2. National reserve banks are incorporated institutions holding federal charters and in all respects managed like national banks except as to the election of directors which is provided for as follows:

(*a*) Banks in every district are divided into five classes according to capitalization. In each class the directors of the banks nominate a candidate for the directorship of the Reserve Bank. These are then voted on (one bank one vote) and a director is chosen for each of the five classes—five in all. (Section 4.)

(*b*) In the five classes aforesaid bank stockholders vote for and elect a director for each class by a process prescribed in each case making five in all, or with the preceding five, ten. (Section 4.)

(*c*) The ten men thus named select four others after a prescribed process, eight votes required to elect, and the nominees subject to rejection by the Federal Reserve Board. (Section 4.)

(*d*) A fifteenth member, to be chairman of the Board of Directors is chosen by the Federal Reserve Board itself. (Section 4.)

3. The Federal Reserve Board consists of two members from each district and the three Government officials already specified. (Section 10.) It is not an incorporated body, has no banking functions but is supervisory.

(*a*) One member of the Federal Reserve Board in each district

is chosen directly by the directors of the National Reserve Bank of the district. (Section 10.)

(*b*) A second member of the Board from each district is chosen by the bank stockholders of the district, voting by a prescribed method. (Section 10.)

(*c*) These members of the two classes referred to choose by ballot four of their own number to join with the Government officers already mentioned as the executive committee of the board. These four are designated by the Secretary of the Treasury to hold the offices of President, first and second vice presidents and secretary of the Federal Reserve Board. (Section 11.)

Reserves

In the belief that the present reserve system is antiquated and unsatisfactory, that the massing of funds in New York and other financial centers of which so much has been said in recent years, is largely due to the present reserve requirements of National banks, and that in order to get the real benefit from the system of rediscount which has been proposed as a remedy for many existing evils, it is necessary to base such system upon an actual control of reserves, provision has been made for recasting the present bank reserve system. The plan includes:

1. Transfer of reserves from existing National banks in Reserve and Central Reserve cities, to National Reserve Banks. (Section 27.)

2. Spreading out of this process of transfer over a period of fourteen months in order to give as little shock as possible to market conditions. (Section 27.)

3. Ultimately the establishment of a reserve system, at the end of the transition period in which so-called country banks will have 15 per cent of reserve (i. e., 15 per cent of total demand liabilities) such 15 per cent to be held 5 in the bank's vaults, 5 with the National Reserve Bank and 5 either at home or with the reserve bank; while reserve and central reserve city banks will have reserves of 20 per cent of demand liabilities of which 5 will be at home, 5 with the Reserve Bank of the district and 10 either at home or with the reserve bank. (Section 27.)

4. The presumed effect of this plan will be to end the placing of

reserves with Central Reserve city banks for use in stock market operations, to keep reserves in some measure at home, and to require speculators to get the funds they need in their operations either by directly borrowing them from persons who hold them and want to lend the cash for that purpose or else by borrowing from the banks in the places where the operations are to be carried on.

Division of Business

The object of the bill is to effect a moderate division and classification of banking business along indicated lines, the net result, presumably, being summed up as follows:

1. National Reserve banks will be strictly limited to actual commercial and industrial transactions evidenced by very short term paper and on rare occasions under carefully prescribed conditions to financial operations protected by collateral. They will also be able to engage in foreign exchange operations, sales of Government securities, etc., as already explained.

2. National banks will be subjected to precisely the same restrictions as at present with a relaxation in favor of a moderate amount of real estate loans by country banks under carefully guarded conditions. (Section 39.)

3. By a revision of the administrative features of the National Banking Act, provision will be made for close oversight of National institutions with a view to holding them strictly up to the requirements of a legitimate banking business. (Text of bill still to be submitted.)

4. In order to possess themselves of the kind of paper entitling them to rediscounts, National banks will find themselves obliged to keep a reasonable proportion of their assets in the form of paper eligible for rediscounting, and this will mean very considerable emphasis upon the strictly commercial aspects of the business done by National institutions.

Position of State Banks

It has not been thought wise to permit State banks to own stock in the national reserve banks for two reasons:

1. State banks by the terms of their organization are differently managed and controlled from National.

2. The laws of the States differ with respect to liabilities, the collection of debts, and other matters.

Hence the bill has attempted only to provide for giving these banks equal facilities for doing business by establishing the following conditions:

1. State banks may affiliate themselves with National Reserve banks by maintaining the same deposits with the National Reserve banks that are kept by National banks under the proposed act. (Section 29.)

2. State banks shall in these circumstances be entitled to do business with and get rediscounts from National Reserve banks. (Section 29.)

3. State banks shall be subject to inspection and examination by National Reserve banks. (Section 29.)

Relations with Treasury

It is believed that the present Sub-Treasury system is unsatisfactory, clumsy, injurious to business and difficult to manage in times of stress. The bill therefore provides for:

1. The placing of all current funds of the Treasury in National Reserve banks and the payment of Government creditors by check thereon. (Section 21.)

2. The equalization of the public funds between the different reserve banks subject to a rate of interest to be fixed by the Federal Reserve Board. (Section 13.)

3. The trust funds of the Treasury are to be held as at present in the vaults of the Treasury.

Foreign Banks

Recognizing that present banking legislation under the National system is inadequate in its relation to foreign trade, because it furnishes far too little recognition of the necessities of the case, and believing that the development of foreign banking ought to be aided and promoted and at the same time regulated by the National Government, it has been sought in drafting the bill to provide:

1. A new type of institutions created for foreign trade purposes

and organized by individuals or existing National banks or both. (Section 41.)

2. Permission to establish branches in foreign countries and whenever necessary under specified conditions to establish such additional branches in the United States as may seem requisite.

3. Authority on the part of the National Reserve banks to deal in foreign exchange and otherwise to facilitate operations involving international trade. (Sections 18 and 19.)

4. Permission to National banks to do an acceptance business in all matters relating to foreign trade, the importation and exportation of goods, the furnishing of travellers' funds on letter of credit, etc.

5. The more efficient and successful handling of financial relations between the United States and foreign countries through the placing of Treasury funds in the hands of National Reserve banks.

APPENDIX ELEVEN

LETTER TO COLONEL HOUSE ANALYZING DR. H. PARKER WILLIS'S SYNOPSIS OF THE FIRST DRAFT OF THE GLASS BILL, APRIL 22, 1913

DEAR SIR:

With reference to Mr. G.'s plan, a synopsis of which you permitted me to see yesterday, I herewith give you a short résumé of my criticisms.

Whether a plan of National reserve banks as outlined in this draft is sound or unsound will depend entirely upon the number of such banks. You can readily see that if you had fifty independent reserve centers, the plan, for many obvious reasons, into which I need not go in detail, would be an impossible one. If you had three, four, or five, I could see that you could develop a desirable plan. I mention the large number of fifty, in order to show that this is not a question of theory, but of practical application. I believe that what Mr. Willis stated in yesterday's *Journal of Commerce* is substantially correct, that most of the men who have been asked how many regional reserve banks will be required, have answered, offhand, about fifteen or twenty. However, I doubt whether any of these men have given the question very careful consideration. What I believe was in the minds of these men, was that there must be at least fifteen or twenty points at which the banker might be able to deal with a central organ. I quite agree with that; I even believe that fifteen or twenty will not be a large enough number in the long run. I have always held that the Aldrich Plan did not provide for a sufficient number of branches. The country is too large and increasing rapidly, and the law must provide a sufficient flexibility, that is a sufficient amount of faucets which can be turned on in each part of the country, so that all important cities can be easily taken care of. While, however, we need a large number of faucets (I think it will

not take long before you will need at least thirty), you need a small number of central reservoirs. To come back to my old illustration. If you establish too large a number of central reservoirs, and provide, as the law does, that there should be a supervisory organ at Washington that will interconnect these reservoirs, and may issue an order that New York shall provide for New Orleans, or Chicago shall provide for San Francisco, or Milwaukee for Texas, you will establish a very cumbersome machinery, and there will be various difficulties in handling the same. There will always be the feeling that you take away something from one locality and give it to another locality, against which there will always be some resistance and resentment, and justly so. Moreover, it will be a terribly round-about and queer way; just consider what will happen if at first Milwaukee should be ordered to help Texas, and then Chicago be ordered to help Milwaukee and ultimately, possibly, New York to help Chicago. It will be very difficult to ultimately read the gauge of how the water really stands in each center, because there will be so much round-about interference. Moreover, it will be impossible to break down the local character of the administration of each center. It will be swayed entirely by local considerations, because the unit is too small; a large, patriotic, and impartial view will not develop; it will always be one part of the country looking out for its own interests against those of the other; instead of having a unit, working all for the same purpose, you will have each corner working for itself. This will not only be a poor organization, unable to bring good results but, in addition, it will be dangerous, because if in a particular locality a strong demand for accommodation should exist, it will be very difficult for these very same men to sit in judgment upon themselves and to decide that such accommodation should not be granted, or possibly be granted only in a hesitating way (in order to interfere with too rapid an expansion). This National reserve bank must very often take the opposite view from those that are in the banking business to make money and to comply with the demands of their customers. When business expands and all is going well, it is the function of a National reserve bank to accumulate funds and provide for adverse times, and vice versa, in adverse times, when the banks have reached the end of their tether and would be afraid to provide,

even for legitimate needs of the country, the National reserve bank is willing to expand. In order to bring this about you have to break down the local or provincial character of each board, and you have to construct large units which, not representing individual localities, will be able to develop more of a national view in all the functions which a National reserve bank should primarily exercise. That is to say, the concentration of reserves, the creation of a discount market, the handling of the government bonds, an elastic note issue, and the accumulation of foreign exchange (to be kept as a reserve in case of need, and incidentally having for its object the withdrawing of the funds of the National reserve bank from active employment in the United States in times of dangerous plethora) can best be exercised if one single reservoir is created. If that cannot be done, for reasons which I can well understand, a few numbers of large reservoirs should be created; three or four, (if it absolutely must be, five, though that, to my mind, would be too many) because then you could get boards for these four units which would be national in character, and they would be in a position to stand by each other, and be mutually responsible for each other and assume joint responsibilities—like the note issue—without feeling that one locality is depriving itself of its own means of sustenance in order to help the other, and that in doing so it may possibly run a risk. A definite and national policy can be developed by so small a number of units, and it can be carried out; (concerning the purchase and sale of foreign exchange, discount rates, purchase and sale of government bonds), a proceeding which is practically impossible with a larger number. If this point of view be adopted, which I do not think is contrary to the principles of the law as drawn at present, I think a very creditable measure may be developed. It may even have some advantages over the Aldrich Plan, because it is possible that these three or four units, if need be, may have different rates of discount, while in the Aldrich Plan the one rate for the whole country may prove embarrassing at times. Moreover, with the Aldrich Plan the fear remained—to my mind without justification—that Wall Street, somehow or other, might secure control of the whole machinery. If three or four units were to be created, New York's influence would be restricted to the East; and the South, Northwest, and West would be entirely

independent within their own domain. To delegate to the Federal Reserve Board the power of fixing the rates for each of the twenty or twelve National reserve banks and to decide upon the question whether they should have additional funds, and which of the others is to provide them, is too large an order. It would be very dangerous for the Secretary of the Treasury or the Attorney General to be involved in questions which are too local in character upon which they cannot possibly have any judgment of their own, and which, moreover, *might easily lead to insinuations and to suspicions of favoritism or unfairness, whichever way they might decide. It is much safer for these gentlemen in Washington to deal with the largest possible units which would protect them in that respect.*

To sum it up: A large number of coördinated units I would consider fatal. The number would either not be large enough to be adequate for the country's needs—or it would be too large in order to be a safe and practical proposition. What is needed is clearly this: A large number of National reserve banks, let us say a provision for up to thirty, beginning with a fewer number for the time being, each equal to the other in rights and privileges, but these National reserve banks are to be put under three or four centers. Let us say, for argument's sake, three centers, each being composed of up to ten National reserve banks, would form one distinct group by themselves. It would be easy to devise some good scheme to have the center of each group administered by members delegated by each National reserve bank, and the Federal government would add the head, and as many more members as Congress might think necessary and advisable. These three (or four) central boards would then delegate members to the Federal Board, of which the governors of each center, three (or four) in number, should be members. You would then have three really important men of national standing, who would have been the choice of those three (or four) sections of the country, to constitute a strong nucleus of the Federal Board, and if you added to those a president of the Federal Board, who would be the head of the whole structure, you would have a cabinet there which would be something secure and to be proud of. To those you would add, as proposed in the bill, some members of the Cabinet of the President of the United States. You would then have only a few inter-

changeable reservoirs, but with a great number of faucets everywhere, and a system that can be handled. Every efficient organization must have heads of departments, and men responsible for each branch as you go down. As the law is drawn now, I see twelve or twenty armies with twelve or twenty generals, but I do not see any captains or any regiments, the regiments, as a matter of fact, have become armies, and you can see where that would lead to. This plan of mine would provide for three (or four) generals, with a general staff in Washington, and each general to be responsible for his seven to ten captains, which constitute his unit.

I regret that I had to be so long-winded concerning this Point One, before coming to the other points in detail, but this is a fundamental principle which we have to establish first, and unless I may consider this as granted and adopted, I would have to go into this question again and again at each point.

We now come to the second point.

Ownership to be in the Hands of the National Banks

I think this would be a mistake. There are several States in which state banks and trust companies, for instance in Illinois, are of greater importance than the national banks. The basis of the National reserve banks ought to be as broad and as strong as possible, and I strongly believe that national banks, state banks, and trust companies should be admitted to the privileges of the new organization on equal terms, provided they submit to certain rulings as to their reserves and to supervision on equal terms as to the holding of stock of the National reserve banks. The holding of such stock is not a bonus but an onus. It means the locking up of funds by these banks of 10 or 20 per cent of their capital, and to permit the state banks and trust companies to come in, as far as the privileges of dealing with the National reserve banks are concerned, and not to force them to contribute as stockholders would not be fair to the national banks. On the other hand, to keep the state banks and trust companies out completely, would create such an antagonism on the part of these latter institutions that the legislation probably could not be gotten through, no more do I think should it go through because it would not be fair legislation. Senator Aldrich started on the same basis of dealing

only with national banks, and was ultimately forced to change his viewpoint as to the state banks and trust companies.

I have no criticism concerning Points Three and Four. Of course it would be very important to know the details of Four A and B, as to what these "specified conditions" will contain.

Note Issue

I think any limit (as in this case twice the par value of the capital stock) is inadvisable and dangerous, because whenever the limit is being approached, helplessness stares the country in the face, and a panic may ensue. I favor a limitation of the note issue by a prescribed gold reserve which is to be maintained. It is then always within the power of the administration of the National reserve banks to take steps, no matter how drastic, to increase the gold holding, and thereby to meet the situation, but you are not up against a fixed limit. If you deal only with three or four large units it would be easy to pool the status of the three or four units, and stipulate that the total note issue should always be covered by at least 33⅓ per cent in legal tender notes, or gold.

(I shall have to treat together the note issue and disposal of the United States bonds.)

I think the plan, as provided in the draft of the law, is a weak one for several reasons. The argument begins by stating that it is proposed to convert the 2 per cent bonds into 3 per cent bonds in order to protect the national banks from suffering a loss on the 2 per cents. This is equitable, but if you consider that German consols within ten years went down from par to 75 per cent and that British consols and French *rentes* moved down in a similar way, you may readily see that there is no guarantee at all that the banks will not incur heavy losses, when finally they can dispose of their bonds. This, however, is not the main consideration, but you have to consider what the status of the united National reserve banks would be when all the government bonds would be in the hands of the public after ten years. We have to presuppose that the amount of currency now used by the country will substantially remain the same. The country has adjusted itself to this amount, and while, on the one hand, possibly, when the national banks will have less interest in keeping out their notes, the circulation may

decrease to a certain extent (which we can only guess at, and which probably will not be very large) the population, on the other hand, will increase, and so will the deposits in the banks, and therefore a larger amount of currency will be required as the years go on rather than a smaller one. Against each note in circulation there must be some asset, because each note is issued only against some consideration. If the government bonds do not figure any more in the status of the united National banks as an asset against the liability on their note issue, and if the National reserve banks assume the old note issue or substitute the new notes for the old ones, which the national banks withdraw yearly, and if the National reserve banks do not acquire the government bonds, it means that the united National reserve banks, in order to keep out the $750,000,000 of notes now represented by the national bank notes, will have to invest $750,000,000 in commercial paper or foreign exchange. This means that at all times, even in times of plethora, the National reserve banks will have to have an actual investment of this enormous amount, and in times of active money, when the function of relieving the market should only begin, they would have to step in with additional hundreds of millions of dollars. This is just what should be avoided. The united National reserve banks should not be forced at all times to be as active in business as that. It would tend towards inflation, which should be avoided. My suggestion would be that an offer be made to the national banks to purchase from them at once their 2 per cent bonds and to assume a corresponding amount of their note issue by the united National reserve banks. The National reserve banks would convert half of the amount of the bonds so purchased into 3 per cent government bonds of which they might be permitted to sell 10 per cent per annum, but they should not be obliged to do so. The other half of the amount of government bonds received would be converted into *one-year* 3 per cent Treasury notes of the United States and the united National reserve banks would undertake to renew these Treasury notes of the United States every year at the rate of 3 per cent whenever they fall due, such undertaking to be in force as long as the charter of the National reserve banks will last. From the banker's point of view the result of such a measure cannot be too strongly empha-

sized. It means that while the united National reserve banks will not be forced all the time to invest in commercial paper, because their money would be invested in government securities, the National reserve banks would not be in the precarious situation in which they would be placed by the Aldrich Plan under which they were forced to hold $750,000,000 which they practically could not sell in case of need. The National reserve banks would, at all times, be in a position to dispose of these $350,000,000 of United States one-year Treasury notes, either at home or abroad, because for a short government note of the United States there will be always money available at a price; it will be only the question of the rate of interest which the National reserve banks would be willing to offer. It would not be difficult therefore to liquidate $350,000,000 even in such a way as might enable the National reserve banks to draw gold from Europe when it should be required, or when it would be necessary, substantial credits could be created in Europe in order to obviate gold exports from the United States. This power to influence the flow of gold is a most important feature which in the draft of the law is completely neglected. I can see everything in favor of such an arrangement, and nothing against it, but I do not want to tire you by lengthening the argument. I furthermore think that it is extremely desirable to deal with this question of note issue and government bonds in a comprehensive way, and not to continue *two kinds* of note issues. (Moreover, if you left the privilege, as suggested in the law, that anybody might convert, after ten years, the 2 per cent bonds into 3 per cent bonds, some of the banks which do not apprehend a fall in the 3 per cents, as outlined before, might indefinitely continue their note issue, which is profitable for them, and take their chances on the ultimate sale of their bonds.) In order to have an efficient hold on the market, it is extremely desirable that there should be a definite policy as to the note issue, and that the note issue at once should become as elastic as possible. If you left the national bank note issue outstanding to a large proportion, as provided in the present law, an effective control by the National reserve banks will be postponed, and I strongly recommend to your careful consideration the modus suggested by me, which by the insertion of the United States Treasury notes brings about safety, control, and elasticity from the beginning.

Protection of Notes. (*Clause 2*)

I do not believe that it is sound not to count notes as reserve when a balance with the National reserve banks is to be counted as reserve. Notes and balances are interchangeable, and if the one is to be counted as reserve, the other should be also, but I prefer not to enter now into this discussion which, from past experience, I know to be a very difficult one, but to deal first with the main questions.

Control of Board

I have nothing to say concerning the paragraph of government control, and agree in principle. As to how feasible or how practical the modus of election is, I have no judgment until I can see how these phases have been worked out in detail.

Reserves

I am somewhat at a loss to discuss the paragraphs dealing with reserves, inasmuch as No. 3 under this heading contains a synopsis which I cannot understand. Dealing with country banks, it is said that "of their 15 per cent they may hold 5 per cent in the bank's vaults, 5 per cent with the National reserve banks and *5 per cent either at home or with the reserve bank* (does this mean National reserve bank or banks in reserve or central reserve cities?) while reserve and central reserve city banks will have reserves of 20 per cent of demand liabilities, of which 5 per cent will be at home, 5 per cent with the *reserve bank* of the district (I suppose this means National reserve bank), and 10 per cent either at home or with the reserve bank." (I fail to understand what this reserve bank means.) With the object that the framers of this law had in mind, that is the development of a discount market and the withdrawal from the stock exchange of the very large amount of reserve money employed there now, I heartily agree. However, two points must be borne in mind. We do not develop a discount market by having twenty places at which banks may rediscount with the National reserve banks. By that we would construct one means of rediscounting, and a pretty restricted one at that. The discount system in Europe provides for a general open market, and of the large amount rediscounted every day, only a small fraction and, as a rule, only the short

maturities go into the so-called central banks. There is, as a rule, one center which is more important than the others, and this center, as far as the foreign countries are concerned, establishes the main standard of credit. These centers are London, Paris, or Berlin, while additional markets naturally develop in the main centers of commerce and trade, such as Lyons, Marseilles, and other cities in France, or Hamburg, Frankfort, Bremen, and many other cities in Germany, the Scotch cities, and the big manufacturing and shipping places in England. There must be certain main centers where discounts are being purchased and sold freely by the banks, discount companies, and private firms, which deal in these bills because they have that free market while, underlying it all, is the expectation that in case of need the central institution will be there to purchase the bills, but this central institution is resorted to only in a comparatively moderate degree in normal times. It looks to me as if it were extremely important that such places as Chicago, St. Louis, Philadelphia, Boston, New York, New Orleans, and San Francisco should develop into discount centers, of which Chicago, St. Louis, and New York would probably become the leaders. In order to bring this about, I think it would be undesirable, at this juncture anyhow, to interfere too radically with the functions of reserve and central reserve cities. I believe that the accumulation of funds in these cities will be a healthy one for the development of these discount markets while, on the other hand, a disturbance of the functions as they exist at the present time might create considerable havoc. Do not forget that financial conditions in this country, at present, are extremely precarious. Fourteen months is a very short time to adjust conditions, and I have grave apprehensions that interference, as planned by the present law, if I understand it, about which I am not sure, might cause most serious disturbances. The mere fact that reserve city banks and central reserve city banks will have in the future within their reach a means of investing their demand deposits in bills of exchange which they can resell, will quite of itself cure the present evil of dumping all this into the call money market of the Stock Exchange in New York. In other words, a bank in Chicago that can rediscount with the National Reserve Bank in Chicago or with the leading banks in New England or in New York,

will not find it necessary any more in the future to keep so much money on call in New York as it did in the past. As a matter of fact, it probably will hold a large amount of bills and keep very little money on call, and only as much as it needs for its daily requirements, unless rates in New York would be inordinately high, and would offer a stimulus for accumulation in New York; but, if you think it necessary, you might provide that banks in central reserve cities should segregate such reserve funds and keep a gradually increasing proportion of them either in cash or as balances with the National reserve bank of their city, or in rediscountable bills of exchange.[1] By that I think the framers of the law would achieve just what they intend. I do not believe in earmarking money for each locality; what we want are reserves and currency that will flow where it is needed in the country.

What I would suggest is that, in addition to the provisions which I have just outlined, it be provided in the law that every bank becoming a stockholder and a member of the National reserve bank be obligated to maintain a certain percentage of the reserves to be kept by law, as a balance with the National reserve bank of its locality.

The country banks at present hold reserves of 15 per cent, of which two-fifths, equal to 6 per cent, must be kept in cash, while three-fifths, equal to 9 per cent, may be kept on deposit in reserve cities. I would suggest that out of the 6 per cent that now must be kept in cash, no less than 5 per cent should be kept as a balance. If amounts larger than the remaining 1 per cent in cash are required for the daily needs of the country bank, those will have to be withdrawn from the 9 per cent which now may be held on deposit, and for banks in reserve cities it might be provided that out of the 12½ per cent which must be kept in cash, a balance of not less than say 10 or 11 per cent should be maintained as a balance with the National reserve bank; the balance of 14 per cent or 15 per cent would be kept as cash or on deposit in central reserve places. Cash and cash balance must be no less than 12½ per cent. For central reserve city banks, one might stipulate that no less than 20 per

[1] I disadvise being too drastic in withdrawing all reserve money from the stock exchange. The country will be the sufferer if the organ that absorbs and digests securities should be maimed!

cent out of the 25 per cent should be kept as a balance with the National reserve bank.

There is no need for large cash holdings in the vaults of the banks as long as they can always manage to receive cash from their National reserve banks against rediscounting their short paper. I believe that, if a modus as suggested here, were to be applied, a very important step towards the establishing of discount markets would be taken and, incidentally, the National reserve bank organization would be considerably strengthened, because you would fix a definite percentage for the deposits of the banks with the National reserve banks. The whole structure would thereby gain in strength, while the Aldrich Plan in this respect, leaving the balances entirely indefinite, was very weak. While in principle I agree that keeping balances in reserve cities and central reserve cities, and counting them as cash, is not very sound banking theory, we must not forget that this is something to which our country has adapted itself, and as a matter of prudence, it is very desirable not to interfere now in a radical way with this machinery. If later on, after the new system has established itself, and when discount markets have been organized, it should prove feasible and desirable gradually to reduce these balances, it can always be done by subsequent legislation. For the time being, the country banks and the banks in reserve cities would all violently oppose any legislation that would too radically interfere with the present system in this respect.

Treasury

The depositing of the Treasury balances would offer little difficulty if my suggestion were to be carried out that there should be only few units. I doubt the wisdom of allowing interest to the Treasury on its deposits, inasmuch as nobody else receives interest on deposits, but this is a matter of minor importance only.

I do not see in the present bill that the various National reserve banks are to be mutually responsible. This is a necessary requirement, but it will be impossible as long as we deal with a large number of small units. If we deal with a few large units, there will be no difficulty in securing the willingness to be mutually responsible for each other. I do not see that the profits of the National

reserve banks are limited to a certain percentage, the balance going to the government. This is absolutely necessary.

I do not see that any liquidating fund is mentioned in the plan. I think it would add to the attraction of the plan if a surplus fund were to be established which would have for its object to pay off depositors of banks in default, up to such a percentage of their claims as would be safe considering the existing assets of such a bank. The National reserve banks might act as liquidators in such cases, eliminating protracted receiverships. This would eliminate the main hardship which defaults bring to depositors of a bank, that is, the unnecessary tieing up for a long time of the deposited funds; the ultimate loss which falls upon them is in most cases not so important.

There are a great many phases which I have not touched upon, because I have tried to discuss only the main points at issue. It is necessary to agree upon those before we go into the details of the question.

I am afraid my criticism is more voluminous than I would have wished to make it, but you have asked me to give you my opinion within a day or two, and I therefore have not sufficient time to condense it, so as to please both you and myself.

If there is anything else I can do to further this matter, kindly let me know.

Faithfully yours,

PAUL M. WARBURG

APPENDIX TWELVE

EXTRACTS FROM CHAPTER XVI OF "AN ADVENTURE IN CONSTRUCTIVE FINANCE" BY HON. CARTER GLASS

. . . There is one episode related to administration which occurred so soon after the system was set up and which was so intimately concerned with the very integrity of original federal reserve legislation itself as to make a reference to it here seem altogether pertinent. The pertinacity of those who held to the consolidationist view of bank credits has already been made clear. As we have seen, they ardently desired a central bank; and, denied that, exhausted every resource of ingenuity to prevail with Congress to make the number of regional banks as few as three, to be located in the three great central reserve cities.

When, after months of consideration and discussion, this was not done, it was supposed the fight was ended. But it was not. The zeal of those advocating centralization was unabated and their persistence unchecked by repeated reverses. They carried the fight into the administration of the system; and, in less than one year after the federal reserve banks were organized for business, the Federal Reserve Board at Washington entered upon a startling task of abolition which might have contravened the purpose of Congress by reducing the number of regional banks to any point at which the Board might have pleased to desist!

This extraordinary action was proposed and entered upon under an interpretation of the statute which, if valid, could have completely subverted the intent of the framers of the law. Indeed, the action proposed marked a critical moment in the history of the federal reserve banking system, for it not only involved an inevitable clash between Congress and the Board, with its attendant bitterness, but also would have precipitated a violent agitation in the districts sought to be abolished as well as in other districts which might proceed in constant dread of a similar fate whenever it

should suit the notion of the Federal Reserve Board to put them out of business.

It was understood to be the intention of the Board to eliminate immediately the banks at Kansas City, Minneapolis, Atlanta, and Dallas, deferring action on the Richmond and Boston banks, with the decision as to the last-mentioned contingent on the willingness of the New England member banks to be transferred to New York.

The crucial point was as to the legal right of the Board to disestablish a single one of the twelve banks. Granted authority, under the statute, to revoke the charter of one, the right to consolidate the system into three central reserve city banks, so desperately, but vainly, fought for in Congress, would have been confirmed. Disestablishment might not have proceeded that far; but it is by no means improbable that it would have gone to exactly that extreme without prompt executive intervention.

The committee of the Board having charge of the matter, composed of Messrs. Warburg, Delano, and Harding, was good enough, to send me a copy of its report under seal of confidence, whereupon I lost no time in writing a protest against the action proposed to be taken, courteous altogether, but unmistakably and severely frank in expression of dissent.

This letter challenged the legal right of the Board to disestablish any regional bank once organized and authorized to begin business, holding that Congress alone could abrogate the charters of a reserve bank and terminate its existence, except in case of liquidation by the Board for violation of law; even in that event, a reorganization was suggested. There was given in the letter a hurried, but I think conclusive, review of the related provision of the Act, with the circumstances attending its consideration and adoption. The argument led inevitably to the view that it would be a stark usurpation of power for the Board to persist in its contemplated course.

It is proper to state that, while Mr. Delano, to whom my letter was addressed, was among those who felt the Federal Reserve Board was authorized by law to take the action proposed and advocated inquiry into the feasibility of it, he was not, as I recall the circumstance, an advanced consolidationist, intent on abolition of regional banks for the mere sake of centralization.

Because of the transcendent importance of the proposition, with its potential consequences, and as a matter of ready reference to the readers of this chronicle who would care to be apprised of the more interesting circumstances associated with federal reserve legislation, the appended correspondence is presented as a fairly clear exposition of the controverted point as I viewed it:

Washington,
November 13, 1915

Confidential

My Dear Mr. Glass:

On behalf of the Committee of the Federal Reserve Board, who have had the matter in charge, I send you herewith the first copy of report which has been prepared, and which will be presented to the Board at the meeting on Monday morning. This is, of course, confidential information which is not being given out but, as the author of the Federal Reserve Act, I think, and our Committee feels, that you are entitled to it. An added special reason for it is that various rumours have gotten out as to what the Committee had in mind to do, and we wanted you to form no wrong impression.

Yours very truly,
F. A. Delano

Hon. Carter Glass,
c/o Raleigh Hotel,
Washington

Washington, D. C.,
November 13, 1915

Strictly confidential

My Dear Mr. Delano:

On reaching my hotel to-night I find your confidential note, with enclosure of report of your committee, for which I thank you. I had read in the Washington *Star* of yesterday a paragraph to the effect that the Federal Reserve Board contemplated some such action as that proposed by your committee; but, being somewhat incredulous, I called Dr. Willis over the 'phone last night to ascertain, if I properly might, whether the

publication had a real basis in fact. Being assured that it had, I to-day prepared a statement for the newspapers in which I challenge the right of the Board to do what is suggested and comment on the reason assigned by the *Star* for the meditated proceeding. However, aside from my utter distaste for newspaper disputation, I am otherwise dissuaded from public discussion of the matter just at this moment.

You have been so consistently courteous and cordial to me, my dear Mr. Delano, and so considerate also, that it pains me to have to disagree radically with any view that you express concerning the administration of the federal reserve system. Yet, the very fact that I have felt so strongly drawn to you and have been so confidently impressed by your earnest devotion to the work of the Reserve Board prompts me to write very plainly with respect to the committee report which you have done me the kindness to transmit.

I was among the few members of the House Banking and Currency Committee who hoped that the Reserve Board Organization Committee would start the system with the minimum number of regional banks. I was among the *very* few members of either branch of Congress who felt that there was much exaggeration of the real peril in Mr. Warburg's "piping" system, which received such scant consideration; so what I say now may not be related to any preconceived prejudice against a reasonable concentration of reserves or liking for a large number of reserve banks. I simply question outright the power of the Federal Reserve Board to reduce the number of banks and, apart from every other consideration, I think such action would be a usurpation of authority for which no defense can be found in the text of the act itself, and I know it would be a perversion of the intent of those who drafted the bill and managed the legislation.

The currency bill, as originally drawn, contained no reference to the question of abolishing reserve banks beyond that involved in the paragraph relating to the charter life of a bank, which could be terminated only by act of Congress or by forfeiture for violation of law. This was held by most of us to be sufficient. But there were members of the Committee so bitterly opposed to the centralization of reserves and so fearful of control by a few banks, in subjection to "special interests," that an amendment was made which provided that

"*no federal reserve district shall be abolished nor the location of a federal reserve bank changed except upon the application of three fourths of the member banks of such district.*"

In vain some of us pointed out that this was in conflict with the "charter-life" provision of the bill; those fearful of a system of few banks prevailed in the House Committee. But the Senate Committee, noting the conflict, eliminated the amendment cited; and the House conferees on disagreeing votes, of which I was one of two, concurred in the alteration, for the reason indicated. Thus we gave the Federal Reserve Board authority to "create new districts," distinctly modifying the term by immediately and clearly indicating that the modus was to be by multiplication, "not to exceed twelve in all." To "create" doesn't mean to "destroy."

We distinctly did not give, even by implication, nor intend to give, the Board power to reduce the number of banks first created. There is not, in my belief, a vestige of sanction in the act for any different assumption. Certainly there is no warrant of authority to "abolish" districts in the power conferred on the Board to "readjust" district lines. Readjustment of lines cannot mean extinction of districts, nor can the power to "review," upon appeal, the work of the Organization Committee in locating reserve banks be reasonably interpreted into authority to "abolish" banks.

No such interpretation of the phrase, standing alone, would be tenable: read in connection with section 4, expressly reserving to Congress alone the right to dissolve banks, such interpretation, as it seems to me, is impossible. But this strained construction of the phrase, if ever admissible, could not be applied now without coming in plain and sharp conflict with the charter-life provision of the act or without involving the federal reserve system in disastrous litigation.

Such action, to be regarded, in any sense as a "review" of the work of the Organization Committee as to chartering banks, should have been taken (1) before the Secretary of the Treasury, as required by the act itself, "*officially announced the establishment of a Federal Reserve Bank*" in a specified district and (2) before the bank proposed to be abolished had been, as provided by the law, "*authorized by the Comptroller of the Currency to commence business under the provisions of this act.*"

But, as I have said, it was never intended that these terms should bear any such construction as that which I fear your committee placed on them, albeit you do not explicitly say upon what sanction of law the Federal Reserve Board would rely for the extraordinary action proposed. I am not a lawyer nor an adept in the interpretation of law; but I do know what the proponents of the Federal Reserve Act and the managers of the legislation intended to write on the statute book.

Moreover, assuming that you have the power, I find myself unable to agree with your committee's argument for the proposed action, and I totally dissent from the printed reason ascribed to the Board for its contemplated abolition of certain reserve banks. Congress did not act carelessly or in ignorance in fixing the maximum number of reserve banks. I am writing hastily at my hotel, where documents are not available; but in the archives of my committee room is abundant evidence of the painstaking care with which expert compilations were applied to this question, and not one of the existing reserve banks falls one dollar under the computation of probable resources made by our actuaries, so there has been no decentralization of reserves beyond that which Congress deliberately sanctioned.

Of course, I do not know with what evidence your committee can fortify its suggestion that Congress did wrong in authorizing, and the Organization Committee in establishing, twelve reserve banks; but I cannot imagine that it relates to lack of resources, because the chief officer of one of the reserve banks proposed to be abolished has recommended to the Board that it shall include in its suggestions to Congress an amendment to the Federal Reserve Act authorizing a return to member banks of 95 per cent of the normally available capital subscribed, thus radically reducing the capital resources of the banks! Furthermore, it is in the power of the Board to make the resources of strong banks available to aid weaker banks in time of stress. It is a complete, not a fragmentary system.

I cannot think, either, that your evidence relates to the reason given in the Washington *Star* for the abolition of certain banks, to the effect that "four of the banks lost money for the quarter ending September 30." You know and I know

that some of the administrators of federal reserve banks have not tried to earn expenses. Quite the contrary, they have tried not to earn expenses; to my knowledge they have intrigued to this end. And this to me is not astonishing, for a member of the Board and your committee, our mutual friend Mr. Warburg, has publicly proclaimed that he would have been "ashamed of these banks" had they earned their expenses.

While I do not agree with Mr. Warburg as to the economics of this view, I am cheerfully willing to concede that there was nothing sinister in his declaration; but there are those who will misunderstand his remark and ascribe it to a desire to wreck the federal reserve system and build upon its ruins his eagerly desired bank of banks. And if the Federal Reserve Board, either through usurpation of power or exercise of authority which the Federal Reserve Act may be thought to confer, should at this time try to abolish certain reserve banks because all the banks have not earned expenses, Mr. Warburg's avowed wish that they shall not be self-sustaining will be plausibly imputed to him and to the Board as undisguised hostility to the system and part of a scheme to discredit it.

And, unhappily, this belief would be accentuated by the incontestable fact that the Board itself, under the persistent leadership of Mr. Warburg, has failed to put into operation mandatory provisions of the Federal Reserve Act which were intended to enable the federal reserve banks to earn expenses, and which no member of the Board, I must assume, will deny would enable these banks to earn expenses. It is my deliberate judgment that the action proposed by your committee, if taken at this time, would arouse a spirit of ferment, and of bitter resentment in the country, especially in the large sections affected, which would speedily be reflected in action by Congress.

I have frankly admonished Mr. Warburg in the kindliest spirit of sincere friendship that his conception of the Federal Reserve System as a purely "emergency" institution is wholly foreign to the view of the administration which recommended and the Congress that brought that system into being. It was never intended by anybody who had any effective part in the inception and passage of this legislative act that these banks

should be practically moribund for nine out of every ten years of their existence and only be put into action to "save a situation" or to retrieve a financial disaster.

If we want a system of that kind, we can return to the hybrid Vreeland-Aldrich scheme, which would enable us to abolish the Federal Reserve Board, as well as the federal reserve banks and conduct the enterprise from a corner bureau in the Treasury Building. I have supposed that in the Federal Reserve Act we had instituted a great and vital banking system, not merely to correct and cure periodical financial debauches, not simply, indeed, to aid the banking community alone; but to give vision and scope and security to commerce and amplify the opportunities, as well as to increase the capabilities of our industrial life at home and among foreign nations. I am not willing yet to think that I have misconceived the thing.

I have written ten times more than I purposed to say, Mr. Delano, when I started to acknowledge the courtesy of your note; and, what is more, have written with my own hand, which is distinctly against my physician's advice. But I cannot conclude without taking the very great liberty to suggest that you should long and carefully consider the astounding intimation of your committee that the federal reserve system, which at the very weakest period of its existence—in its infancy, so to speak—has withstood the shock and upheaval of the greatest war in the history of the earth, will, in its growth and strength, be gravely endangered when the readjustments of peace ensue.

To me this is startling. I believe such a forecast of deficiency seriously made public by the Federal Reserve Board would alarm the country to the point of panic, and do it instantly. I believe it would put a check to enterprise and a rein upon endeavor that would result in immediate doubt and ultimate disaster. I do not at all participate in your fears. I think we have a good banking system, which will continue to prove itself in larger measure as those who administer it give it a fair chance and operate it with confidence. I know you want to do this, and I could wish for you no greater distinction, nor for our country any greater blessing, than would be involved in the actual achievement.

I hope to be able to have this letter typewritten before I

leave for New York Monday morning and to subscribe myself, with cordial regards,

Faithfully yours,

CARTER GLASS

Hon. F. A. Delano,
Federal Reserve Board,
Washington, D. C.

Whether this letter of mine influenced later events, I shall not pretend to say. The note to me was received Saturday night, November 13th. My reply was written instantly and dispatched early Monday morning. The action contemplated by the Board for Monday was deferred for one week to get legal advice from the Attorney General of the United States, who was furnished, by request, with a copy of the foregoing letter. The opinion of the Attorney General was adverse to the action proposed by the Board, and the matter was not pursued.

However, for the moment, the suggested procedure provoked intense feeling among those privy to it. The Board was arrayed in two factions, the division being four to three, one side assuming to be trustees for the banks and viewing the other as representing the government. My data, made at the time, reveal the existence of astonishing hostilities and a threatening situation.

On Saturday, November 20th, in a long talk at his home, I warned Mr. Warburg that the Board should not pursue the course it had in mind without first getting the sanction of Congress by amendment of the Act. On Sunday, November 21st, the day before the appointed time for the Board to act on the committee report, the President summonded me to the White House for a conference on the subject. He knew one side of the various controversies which had disturbed the Board. I gave him both sides, derived by me from conversations with members of the opposing factions.

The President asked me if I did not think the situation was sufficiently threatening to warrant an immediate reorganization of the Board. Against this, at the time, I strongly advised, for reasons which subsequently were set down in my diary, the text of which reproduced here would make reading decidedly more

interesting than judicious. There can be no possible doubt that the Board would have been summarily reorganized by the President under his power of removal had it taken next day the action which was contemplated.

The President, aside from being greatly exasperated, wholly concurred in the view that such action by the Board would constitute an intolerable usurpation of power, without either textual or implied legal sanction. Happily, the thing was not done; and soon thereafter a better concert in the Board seemed to prevail.

As far as I know, this was the first and only time President Wilson ever approached the point of executive intervention with the affairs of the Federal Reserve Board; and this time he felt that he must act to avert what seemed to him a plain defiance of the will of Congress, albeit the Board was fortified by an approving opinion from a New York lawyer whose obliquity of vision in contemplating federal reserve legislation was as consistent as it was extraordinary. Distinguished in his profession, he never once appeared able to understand the genius of the federal reserve system or to comprehend what it was all about.

APPENDIX THIRTEEN

LETTER TO SAMUEL UNTERMYER

R. M. S. "Mauretania",
May 24th, 1913

DEAR MR. UNTERMYER:

I take great pleasure in enclosing to you the argument which I prepared at Senator Owen's request, and which I would thank you to forward to him for me. As I said at the end, if I had had more time—or rather if I could afford to give more time and energy to this document—I could have condensed it and made it a little bit more scientific; but as it is I should be much disappointed if it would not convince you and the Senator as to the correctness of my views. The deeper I got into the subject the profounder grew my conviction that there could not be any doubt that the scheme which Senator O. tentatively discussed would be a misfortune. I need not go any further, but rather prefer to let my argument tell its own story.

I should like, however, to come back to one point which you and Senator O. touched upon during our discussion. You or he asked me what was the matter with the financial market conditions, and you both expressed the views that the main cause for the present conditions was that the banks and trust companies in New York were over-invested in securities. This question has an important bearing upon the larger problem that we discussed and, therefore, I should like to come back to it to-day. . . .

New York is a highly developed center for the absorption of securities without the existence of which we would be hopelessly handicapped in the development of our continent. Like in Europe, industrial corporations have outgrown the banks; they are so large that enormous organizations are necessary to carry through the financing of these concerns. Moreover, for the development of the discount market it is most important that money centers

exist as they do in Europe. Our legislators ought to be very careful not to cripple the security market, or the development of a discount market, by too drastic interference with the flow of reserve money. Naturally, as I need not explain to you, the development of a discount market will break the accumulation of funds on the stock market, and it will break largely the flow of money to the present reserve centers. It is not necessary to accentuate this by tieing up the entire reserves either as balances with the Federal reserve banks, or as cash. I have always argued that a certain and generous proportion of the present legal reserves should be kept as a balance with the Federal reserve banks, but the remainder of these reserves should be permitted to flow into the reserve and central reserve cities, where it might be kept as a balance with the Federal reserve bank by the banks of such reserve or central reserve cities, or where by law it might have to be invested in short commercial paper or bank acceptances. This would tend towards developing the open market for bills in these cities. . . .

As far as New York is concerned, I have always to think of the Roman fable—of the hands and the stomach that got into a fight because the hands refused to do all the work, while the stomach did nothing. You know how the story ended, and how the hands could not work when they refused to feed the stomach. There is great danger that the game of "blaming it on New York" and on the corporations is being over-played, and that even when New York is entitled to sympathy and assistance the hands may refuse—until they feel it in their own bones that they are doing a stupid thing.

This is another reason why a sane, neutral business management with a safe addition of government representation should run the Federal reserve banks, which must be kept impartial and fair towards everybody; but it is another reason why it is absolutely necessary to keep them out of politics. . . .

I am very grateful to you for having secured for me the opportunity of submitting my views to Senator O. and I appreciate sincerely your own readiness to help in this matter. If you will succeed—as I hope you can—in bringing this problem on a safe and sound basis, you will have rendered a great patriotic service, just as sure as history would write you down as one of the forces

at work for the destruction of your party and your country if you were found on the side of those who will try to force upon the United States a new era of fiat money.

If there is anything further that I can do to help along this matter, you know my deep interest in it, and how glad I shall be to do so, and I shall consider it a privilege to be kept advised as to further developments and to be permitted to give my advice —whatever that may be worth. . . .

With kindest regards, and hoping that you will spend a very pleasant summer, I am

Yours very truly,

PAUL M. WARBURG

APPENDIX FOURTEEN

MEMORANDUM WRITTEN ON THE "MAURETANIA" FOR SENATOR OWEN AND MR. UNTERMYER

May 24th, 1913

When I had the honor of discussing with you the question of banking and currency reform you asked me to prove to you in writing whether it is not a matter of sentiment rather than sound reason that the government should not issue "elastic currency."

I have given the matter the most earnest consideration and have gained the conviction—even stronger than before—that both from the theoretic and practical points of view it would be unsound and fatal to let the government become the issuer of elastic currency instead of placing this function with some kind of a chartered organization.

Government obligations are being issued in payment of government debts incurred, or to be incurred, for the duly authorized expenses of the nation. It is further a separate function of the government to provide a standard of value and exchange by coining, and undertaking to coin, gold of a definite weight and fineness, and establishing this coin as the standard of the nation. For greater convenience of the public, a government may act as a kind of safe deposit, issuing its certificates against the deposit of gold, thus saving the public the inconvenience of carrying large quantities of gold. In addition, the government issues a certain amount of subsidiary coins, or small notes representing such subsidiary coins, which at times do not represent the full bullion value as compared with gold (or which sometimes are without any metallic cover), but which are accepted at par by the public as long as such amount of not fully secured or unsecured notes is not issued in excess of the actual requirements of small denominations by the people, and as long as they remain a comparatively small percentage of the gold circulation. The aggregate amounts of these notes outstanding are, however, fixed by law. The people

at home and the nations of the world carefully scrutinize the financial status of a nation, and it is most important that the credit of the government be firmly established and the proportion of not fully secured notes be kept small. Because the very moment that any apprehension might arise that the gold standard of a country is not well-established, or that it is being materially weakened, unrest and disaster will follow. Almost every country has thousands of millions of securities and bills of exchange payable in gold. Of these, very substantial amounts are being held by other nations. The moment apprehension starts as to the solidity of the gold standard a return flow of securities begins to an alarming degree which, together with alarm at home, may create an acute crisis.

We all know that there is not gold enough to pay in actual cash all deposits or all debts which are payable on demand, if the latter be demanded by everybody at the same time. Normally, the majority of all payments of modern communities is effected by an exchange of credits, by checks, by clearings, or by bank notes, which are deposits in "bearer" form. In order to provide against the possibility of a general demand for cash against all cash obligations, modern nations have created central clearing houses for credits and cash, which are the central banks. These are neutral reservoirs for the idle cash of the nation, into which all free notes or coins flow back. To this joint reservoir—by common agreement, with the consent of the government—the power has been given to issue notes not only against the cash which it holds, but also up to a certain and well defined percentage against its other assets, being mainly short commercial and banking paper, and sometimes a limited amount of government securities. The safety of such a structure lies in the power of such an institution to keep itself strong enough to command gold, by collecting its maturing paper, its foreign exchange, or selling its holdings of government Treasury notes; and to attract foreign, and to bring back local, money by increasing the interest rate of the country. The entire structure rests on this ability of the organization and on the confidence it commands which prevents money from being hoarded.

The central banks in Europe, though the official organs of protection of the nation, are private corporations, because only as

strictly business organizations can they constantly keep in touch with that great fabric of credits, which it is their function to keep in safe proportion to the available gold cover. These central organs must be able to move quickly on the spur of the moment, and deal with eventualities as they arise without "red tape." No political motive must enter their considerations, except when there is a national policy involved. They are bound by certain iron-clad rules as to their gold cover, taxes, investments, etc., but within these rules they act freely and promptly. The government has no voice in the management in England; in France and Germany it appoints the governor and certain members of the board, but the responsibility rests with this board. The fact that these banks are the government's agents and trusted organs carries conviction and confidence, so that the notes of these banks pass from hand to hand practically as government money. But no government of repute assumes the function of a direct issue of elastic notes (that is against commercial paper). The State may issue its own obligations to pay its own fiscal debts, but it is not the function of the State to buy commercial paper and issue its demand obligations for it, so that if Mr. Jones wants to do a large business in sugar, tea, cotton, or in manufacturing, the government would have to increase its debts in order to pay for the same.

The central bank is the joint cash clearing house for the banks and the government—an institution for the existence and safety of which both banks and government are willing to keep large idle cash balances. At times this central bank helps the banks (that is the people) and the government, and at times it restricts them both. I remember at the bankers' convention in Munich last summer that the situation of the Reichsbank was discussed, and that the general conclusion was reached that the Reichsbank must be strengthened in order to cope with the larger business of the nation. As a solution it was decided that the banks would have to keep larger balances, but that the various State and Federal governments would have to keep larger balances too, to which the government representative present at the meeting agreed. In consequence, the Reichsbank—in spite of adverse conditions—has this year increased its gold holdings very materially.

The central bank will place government securities; at the same time it will warn the government when the country needs a rest from such issues. No sound government would think of eliminating this valuable servant of both the government and the people and charge the government in a direct manner with this function. If the government instead of remaining a customer became the central bank itself, or if it became half principal half customer by issuing the notes instead of having them emitted by the central bank, its entire status would become confused. The principle that the government may issue currency notes against assets other than bullion is a dangerous one and, once established, apprehension would at once arise that sooner or later a careless or stupid administration might give way to some popular notion that the government could stand another dose of inflation, and that the paper press might again be set going. Such fear would be fully justified!

A central bank is run upon conservative business principles, generally under effective though indirect government supervision. If it is lacking in conservatism the government can interfere. If, however, there is a weak or inexperienced government and *it* owns and runs the banking business, there is no help or redress.

In France many a government has gone to pieces since Napoleon I; but the Banque de France survived safely. The notion that the government is stronger than a country's central bank is not quite correct. A central bank has its own substantial capital that the business prudence of its administration will want to protect; it enjoys the best management the country can give, a permanent and well-trained staff, while government officials enter unprepared and do not hold their offices for more than a comparatively short time. A central bank can act promptly, without being hampered by political considerations; and in this ability to clearly gauge the general conditions with which it is in daily business contact, and to adjust itself to the same, or adjust the conditions to its needs, lies the safety of the central bank. Finally, its ability to move is not hampered by the difficulties with which a government must move with due consideration of its prestige.

For the proper protection of the countries' gold reserves central banks are forced to resort to measures hardly compatible with a government's dignity, such as the granting of secret facilities in

connection with the importation of gold, or such as the recourse to artificial measures delaying or rendering more difficult legitimate exportations of gold. To contract for a loan of gold—as has frequently been done between the Banks of France and England—is one of the most effective measures of defense of a nation. Should the United States as a government apply to the Banque de France or the Bank of England—private corporations—and beg for a loan? Should it do so through the Ambassador? Can it afford to do that and be refused? Or, should the United States as such—in order to avoid some panic, conceivably due to over-speculation—issue and sell abroad $50,000,000 of its one-year Treasury notes on, let us say, a 7 per cent basis, though the United States Treasury as such may not need the money? Would it not be more advisable that the Federal reserve bank, which in that case would need the gold, would sell the Treasury notes which (under the plan which I had the honor of outlining to you) it would own, and that *it* should take the loss in selling its own assets, while the government would be protected from offering its own securities at "forced sale" prices? It is true that indirectly the United States would be affected by such a transaction, because the profit to the United States that year would be smaller; but that is a minor consideration. That profit, *if used for increasing the gold cover of the greenbacks*, would not appear in the budget of the United States. Moreover, this share in the profit is being given to the United States, not so much as a source of income, but as a means of preventing the Federal reserve banks from being managed as money-making concerns. Only as a matter of last resort would the government step in and sell to the central bank some issue of its own securities leaving the proceeds on deposit with the Federal reserve banks, while the latter might sell such government bonds in the market in order to strengthen its position. The government can do with perfect propriety for a central bank, which represents the interests of the entire nation, what it cannot do directly for any individual bank. If the government issued its notes direct, and if it were to issue them for the benefit of any particular district, there would be the twofold danger that the government might *not* help where it should, because the cry of favoritism might be raised and, inversely, where rigid restrictive measures might be required

they might not be taken on account of the imminence of an election, or for other political reasons which are bound to prevail if the government becomes directly responsible. One need only recall the political pulling that began when the Treasury had to deposit its millions in 1907. The English government could not have saved Barings and ended the crisis—the Bank of England could. This does not apply to emergency cases alone, but to the daily management of the reserve banks. If the United States Government issued the notes direct it could not stop there, but it would have to go to the full length of assuming the management of the reserve banks from beginning to end, because a divided responsibility cannot exist, and notes and deposits are interchangeable and cannot be kept distinct.

If the government became the issuer of the notes, the government would become the central bank. Any depositor may at any time ask for notes, or even gold, against his deposit with a bank; this would force the bank to secure notes from the Federal reserve bank and force in turn the Federal reserve bank to ask the government for notes (against rediscounts). Therefore the government cannot deal with circulation alone, but must deal also with credit.

I cannot quite fathom how it was intended to deal with these vast elastic powers that Congress would have to delegate to a few men, and I am not quite clear what plan in detail is contemplated. Is the government to turn over these notes free of any charge to the Federal reserve banks? I should rather think that it is intended to let the government rediscount for the Federal reserve banks at a discount rate fixed by the central board. That would be entirely logical, but it would then make the Treasury the ultimate central bank on which all the Federal reserve banks would lean, and it would ultimately become the recipient of the cash reserves of the banks.

I am frank to say that I am unable to find my way through the plan, but am afraid that this may be due to my own lack of knowledge of its details. But this is clear to me: a divided responsibility will not do. It is either the Federal reserve banks' or the government's business. One must be fully responsible for both deposits and notes. To permit the government to be dragged so far into business I consider the gravest danger for our political and social

life, and from a business point of view it will weaken the government's credit and make the service to be rendered less efficient and less economical.

I claim there is no reason for such a step, which is not a sentimentality, but which, for the very reasons that I have mentioned, is abhorred by every other nation. What right have we to disregard business experience which has stood the test of time? History tells us the result of government note issues practiced by other nations. Before 1907 people used to answer me when I preached the necessity of banking reform, pointing to Europe's better experience, that our country represented the more modern and more efficient system and that Europe would imitate, sooner or later, *our* system. This I was told by leading bankers! Did we not disregard prudence and follow some over-confident notion when we plunged into our silver purchases; did we not have to pay for that and for the greenbacks? Were we not threatened with a youthful and untried notion of guarantee of bank deposits with the same argument "that the people wanted it"? Those that got it, paid for it heavily. How much do "the people"—and the majority of their representatives—know about this question? I do not believe that any public clamor can possibly be permitted to pull this work of reform from the paths of greatest safety, paths that have been tried. No experiments must be permitted with a problem of such intricacy where an apparently slight deviation may cause the most fatal consequences.

What would be the reasons for taking so far-reaching a step? As I understand it, there are two arguments brought in favor of it:

1. That the government is in it or behind it anyhow.

2. That otherwise the notes—inasmuch as we must not have a central bank—would not be good enough.

Let us consider first the second argument.

Some months ago I made an arbitrary division of the United States into four zones, which is as follows:

1. *East* (11 States and District of Columbia)

Maine, New Hampshire, Vermont, Massachusetts, Rhode Island, Connecticut; New York, New Jersey, Pennsylvania, Delaware,

Maryland, District of Columbia.

Deposits of banks and trust companies,	(in millions of dollars)	Capital of banks and trust companies,
6,566		1403.7

II. South (15 States)

Virginia, West Virginia, North Carolina, South Carolina, Georgia, Florida, Alabama, Mississippi, Louisiana, Texas, Arkansas, Kentucky, Tennessee, Missouri, Kansas.

1,872.8	569.

III. Middle West (10 States)

Ohio, Indiana, Illinois, Michigan, Wisconsin, Minnesota, Iowa, North Dakota, South Dakota, Nebraska.

3,344.1	611.6

IV. Pacific and Western (12 States and Alaska)

Montana, Wyoming, Colorado, New Mexico, Oklahoma, Washington, Oregon, California, Idaho, Utah, Nevada, Arizona, Alaska.

1,052.4	211.8

Summary

	States	Capital	Deposits	10% of Capital
		(in millions of dollars)		
I	11	1,403.7	6,566	140
II	15	569.0	1,872.8	57
III	10	611.6	3,344.1	61
IV	13[1]	211.8	1,052.4	21
		2,796.1	12,835.3	279

From the summary you will see that 10 per cent of all capital of banks and trust companies would furnish a paid-in capital of about 280 million dollars; add to that a further liability by the banks of the same amount, and you have a capital and liability of 560 millions. Even if some institutions stayed out, there remains a

[1] Including Alaska.

tremendous sum as a joint guarantee for the notes. There cannot be any doubt that such a joint guarantee for the notes could be worked out satisfactorily, but I shall refrain from doing so here. These notes would be issued by a joint issue department at Washington under the audit of the government. Whether they should have different letters for each zone, whether each of the four zones should redeem its own notes at Washington when notes of one zone would be presented for payment by the others, I shall not discuss at this time; as far as the public is concerned there would be *one* note issue for the entire country. The national bank notes having been assumed by the four reserve banks in proportion to their stock capital, the 3 per cent government bonds and one-year 3 per cent Treasury notes which the four reserve banks would have received in exchange would be kept in Washington to be dealt with from time to time in accordance with the resolutions of the Federal Board.

You would then have an initial balance sheet, about as follows:

Cash (or bills discounted).....	250	Capital. Say about.....	250 mill.
Cash.....	560	with further liability of	
Government 3% bonds.....	375	250 millions	
Treasury one-year notes.....	375	Cash deposits by banks	
		Say 40% of their legal cash	
	1,560	reserves.....	560 mill.
		Note issue of national banks	750 mill.
			1,560
Cash.....	140		
		Treasury balance,[1] say...	140
	1,700		1,700 mill.

It will not be long till the Federal reserve banks with the help of the Treasury and the banks will have substituted their own notes for at least an additional 500 millions of gold certificates, when the balance sheet will read as follows:

[1] I take this low amount tentatively, to be conservative.

Bills discounted	250	Capital	250
Cash	1,060	Banks' deposits	560
Cash from Treasury	140	Note issue	1,250
Government 3 per cent	375	Treasury	140
Government Treasury notes	375		
	2,200		2,200

At this point there would be 1200 millions cash against 1250 millions of note issue, while 250 millions would have been invested in rediscounts.

If you added 400 millions to the bills discounted and added the entire amount to the note issue, there would still remain a gold cover of 70 per cent, and the Federal Reserve would have in its vaults still untouched its 375 million dollars of Treasury notes as a valuable reserve.

This is so strong a position, so immensely stronger than that of any other similar institution, that I fail to see why the notes of these institutions should be good and ours—should not. I shall not burden your mind with a repetition of the details of a structure of this kind, but shall be happy to submit the same if you desire. It may suffice to say here that these notes would be good beyond peradventure and would be accepted without hesitation.

It is being argued that the United States Government would have to stand behind this note issue anyhow, and therefore might just as well assume the responsibility from the outset.

I do not believe that the United States would ever be called upon for assistance if this organization be constructed right; but even if it should, it could not possibly do more than increase its Treasury balance, or sell (as stated before) to the Federal reserve bank a government security which the Federal reserve bank might resell. The knowledge that this might be done in case of need is sufficient to maintain the credit of the notes at all hazards, even though it never may be done. But I repeat that the government could do this for the country at large, as represented by the Federal bank, while it could not do so for a section or a particular city if it operated directly. Financially the government is, therefore, not "behind it"; quite the contrary, the government will receive a

large income from these institutions. Morally the government stands sponsor for securing a faithful and efficient management. It has powers to appoint members of the various boards, the governors, and is represented by some members of the Cabinet. While the government thus sees to the integrity of the board, it undertakes financially no direct obligation, and the management must remain independent, uninfluenced by political fear or favor, and must not become a branch of the government. The distinction is narrow, but all-important, for reasons which I will not tire you to repeat.

If it should be thought necessary that the United States *guarantee* the notes, I would submit to that—though a little reluctantly—but I am positive *that the direct obligation of* the United States must be avoided. The door would be opened wide for confusion, distrust, temptation, and suspicion—and inefficiency at the same time.

There is no reason whatsoever why a bill which might redound to the highest credit of the Democratic party should be needlessly dragged over this slippery ground where it will end in discredit if it ever be enacted. Personally, I feel confident it never could become a law.

Now let us analyze the proposition of issuing the elastic notes direct, merging the gold stock of the United States with the commercial paper as note cover. In that case if the United States Treasury issued a weekly statement of its gold cover behind the notes, it would of course have to include the greenbacks and the national bank notes, which the government would have to assume, taking the government bonds into the Treasury as a free asset (or possibly selling some in the market to increase the gold holding; but it would be difficult to accumulate gold rapidly, because it must be withdrawn from somewhere, be it from the banks or from abroad, and it cannot be done suddenly). It would be too great an anomaly to let the national bank notes remain outstanding under the plan proposed; that would lead to a situation where, on the one hand, the national banks would issue notes against government debt and, on the other, the government would issue currency against bank assets. Moreover, the metallic cover applies to all notes of the country, no matter where issued.

The silver notes would not be fully covered by their bullion value, and in a statement of bullion cover a shortage of (at a guess) about 200 millions of the 464 million dollars of silver certificates would have to be taken off. We would then reach the following figures:

Gold certificates in circulation	990	
" " in Treasury	85	1075
Silver certificates		474
U. S. notes		346
National bank notes		726
		2621

There is at present a bullion cover as follows:

Gold	1075
Silver	274
	1349, or about 50 per cent.

If we took the same illustration as in the case of the Federal banks, that is to say, if we assumed that about 500 million dollars of the old gold certificates were turned into new certificates, and if we added a new note issue of 400 millions for discounts, we would obtain the following result:

Gold certificates in circulation 490 covered by 490 of gold.		
" " turned into new notes	500	
" " turned into new notes by Treasury	85	585
Silver certificates		474
U. S. notes		346
National bank notes		726
		2131
Bullion gold cover	585	
Bullion silver cover	274	
	859 or about 40 per cent.	
If you add for new circulation issued against commercial paper		400
		2531

you are down to 34 per cent, as compared with 70 per cent, under the Federal Reserve Bank Plan. Even if you supposed that every gold certificate were converted (which will take a great many years) and took the entire additional 490 millions as gold cover, you would have a bullion cover of only 44 per cent, when 400 millions for commercial paper had been issued.

I believe that during the Cleveland crisis more than 200 million dollars were withdrawn (but I am writing from memory). If during the first years, when approximately 500 millions had been converted, 100 millions were to be withdrawn, the cover would go down to 30 per cent; 200 millions would bring it down to 26 per cent, and this would be bullion cover (not gold!) there being about 40 per cent of the bullion in silver.

The difference between the two schemes is this: Under the Federal Reserve scheme we take all legal tender money *as cash*, taking the United States money at full value and providing for a gradual full gold cover for the greenbacks (and the deficit on the silver cover might later on be covered in a similar way).

By making the United States Government the note issuer we throw the searchlight on the defects of the present status and this must be done pitilessly, because the papers, economists, and bankers will do it for us if we don't, and because the new privilege of issuing notes without full metallic cover will make everybody scrutinize the status constantly and more carefully. Moreover, the Federal reserve bank provides for about 260 millions of new capital paid in (with a liability of an equal amount), and the balances paid in by the banks in cash add another, let us say, 400 to 500 million dollars, all of which does not accrue to the benefit of the status of the Treasury.

The four Federal reserve banks would be an added strength to the United States, and the United States Government, as a supervising "big brother" ready to help in case of need, would be an added strength to the Federal banks. Independently, they will be towers of strength, merged—in the way proposed—they will be politically and financially a source of danger and object of criticism.

I have to apologize for this kind of a rambling argument; had I the time and strength to do so, I would begin now rewriting and

condensing it, but I have not quite regained my sleep since my operation and am supposed to rest in the sun and not to work. My figures are mostly from memory and roughly made up, and you will have to bear with me in case there should be any mistakes.

I hope that my argument carries conviction: you have put the question to me—not as an expression of your own conviction, but because you wanted to have the reasons on the negative side. I have given them to you without hesitation and expressing my profound conviction. If I can be of any service, please command me. I shall always consider it a privilege to be permitted to co-operate in this most important work.

P. M. W.

APPENDIX FIFTEEN

LETTER TO DR. A. PIATT ANDREW

MY DEAR "DOC":[1] December 5th, 1910

Since our last meeting at . . . I have given careful consideration to the various questions which we then discussed, and I hereby submit in writing some of the thoughts that have been running through my mind since. . . .

[There follows a long dissertation of how investments and gold withdrawals would affect the National Reserve Association as envisaged at that time and what the consequences would be if a free exchange of bank notes for gold (unhampered by a tax) and the inclusion of National Reserve Association notes among the reserves of member banks were permitted.

Three elaborate tables offering all sorts of illustrations showing the effects of investments and gold withdrawals under both methods are attached to the letter. It then continues as follows:]

In establishing the new bank, we have to bear in mind that, in cutting the coat, we shall have to be prepared for a continued growth in the business of the country at about the same rate as in the past. If we take it that we start off with deposits of $1,000,000,000, and if we allow for a growth of reserve money at the rate of about $65,000,000 a year (which I believe is about the average increase of the cash holdings of the national and state banks for the last twelve years), we must be prepared for a gradual growth of the "deposits" (which represent the cash reserves of the banks) that may reach $1,500,000,000 well inside the next ten years. Unless we want the bank to approach a dangerously low proportion of liabilities, and unless we want the bank to be a permanent investor in discounts, etc., to the extent of $700,000,000 (and more, as we shall see later on), it is most important that, as the deposits of the bank must increase, the gold holdings of the bank must increase too. This can be done in two ways:

[1] The letter was written to Dr. A. Piatt Andrew, Special Assistant to the Monetary Commission, to whom I often addressed my arguments instead of to the Senator direct.

1. By the gradual exchange of the existing United States lawful money circulation for notes of the bank, and

2. By the acquisition of new gold against the issue of new bank notes.

Both can be done only if the issue of *new* bank notes against gold be left tax-free. It can also be achieved only if the bank notes gradually become the only circulating medium (excepting the smaller denominations, which in the form of silver certificates would gradually become absorbed).

It is interesting, in connection with this thought, to consider the effect of the retirement by the government of the United States bonds held by the new bank. If, for argument's sake, we suppose that the entire $700,000,000 of bonds are taken over now by the government from the bank, and if these bonds are then sold to the public, what will the consequence be? The bank could not withdraw all the circulation now issued against these bonds, because the country, being used to that amount of circulation, could not stand a withdrawal of $700,000,000; it could, therefore, not withdraw and accumulate cash against these $700,000,000, and consequently, would very likely have to invest the larger proportion of this amount. The result would then be, that either the bank would practically have to repurchase a portion of the bonds which the government would have bought from it, or invest in foreign government securities unless it wanted to invest an excessively large amount in short and long bills, thereby unduly stimulating business in the country.

The solution then offers itself, that the government should pay off a limited amount, let us say, $50,000,000 a year, and pay it off in actual gold. The government should not increase its issue of gold certificates, but the surplus gold production in excess of these $50,000,000, excepting such amounts as are needed for new gold coins, should be purchased by the new bank.

One might imagine that after six annual payments to the bank of $50,000,000 each, the duty of the government to continue such payments might cease and, having reduced the government bonds held by the bank by $300,000,000, the balance might be held indefinitely by the bank, in a form to be agreed upon. After

completion of these six payments, one might suggest that for the following four years $50,000,000 gold annually would have to be purchased by the government to provide for a full gold cover for the greenbacks. At the expiration of ten years one would then have an almost uniform note issue in the United States. . . .

Would this be inflation of the note issue? To my mind, the forced and encouraged accumulation of gold by the bank would discourage inflation while, if the acquisition of gold by the bank be handicapped by a tax, it would have the reverse effect. For while the holding of gold, as compared to a holding of interest-bearing investments, means a loss to the bank, a conservative management will be willing to forego the additional income for the sake of the general safety of the country; but it would be asking too much to force them, not only to sacrifice a possible profit, but to incur an actual out-of-pocket loss for increased gold holdings. Moreover, if United States gold certificates continue to be issued and continue to circulate freely, whatever inflation will have to come in times of stress, will of necessity be thrown on the circulation of the new bank. Instead of being divided over the whole circulation, the missing gold cover would loom up disproportionately large in the circulation of the new bank, and apprehension and even discrimination, which would be fatal, might ensue in critical times.

The argument that the larger scheme, as here outlined, would lead to dangerous inflation of the general circulation of the country, is good only if all the safeguards with which the possible investments by this bank are surrounded (and which, as a matter of fact, would render impossible the investment of excessive amounts), be considered as non-existing, and if it be taken for granted that a management composed of the best elements of the whole banking community should either be blind or willing, with open eyes, to wreck the country. But unless we are prepared to believe in the soundness of the whole structure and in the common sense of the management, the present smaller scheme would not be safe, because even now, without adding any new gold circulation, the management could inflate the note circulation by $2,400,000,000 (!) over the present national bank circulation of $700,000,000, before it would reach the limit of 33⅓ per cent of the gold cover.

It is, to my mind, a very important question whether one should not restrict the bank by a certain percentage of liabilities rather than by fixing this limit for the note issue, for the reason that the liability limit would be the more effective one, or whether the 33⅓ per cent limit for note issue should not be increased to 50 per cent; but, be that as it may, the deeper one goes into these questions, the firmer grows the conviction, that the broader foundation of giving the new note the widest possible circulation and the highest possible standing, will prove the safer and more conservative basis for the future structure.

The difference between Mr. George E. Robert's plan and the present suggestion is, that, as far as I remember, Mr. R. proposed that "the Treasury turn over its gold to the bank." The Treasury's gold being pledged to the certificates, it cannot turn over "its gold." But nobody can prevent a holder of gold certificates from demanding the gold in exchange for the certificate. The present plan makes the new bank the largest holder of lawful money and enables it, only through this ownership, to become the actual owner of so large a portion of the Treasury's gold. Whether we start with $1,100,000,000 of lawful money or whether we gradually increase it, as *we must* in due course, to $1,500,000,000 or $2,000,000,000 will not make any difference in principle, but will make a great difference in fact.

All that will be necessary will be to insert in clause . . . "that national banks may pay each other in these notes and count the same as reserve money" (which will not arouse criticism unless the whole scheme of counting balances with the new bank as cash be attacked) and furthermore a tax clause, carefully worded, which I believe can be worked out to everybody's satisfaction. (Table III deals with this question.)

I submit these thoughts to you with great hesitation, since I do not feel at all that the few figures which I have compiled cover the field fully, nor is it my intention to present conclusions. However, in struggling with a problem, one cannot help reaching certain results from time to time, and the only object of this letter is to invite you kindly to follow me into the labyrinth into which my mind has led me and to help me find the way out, should I have gone astray.

P. M. W.

APPENDIX SIXTEEN

MEMORANDUM ON THE REDISCOUNTING AND OPEN-MARKET OPERATIONS CLAUSES OF THE OWEN-GLASS BILL, OCTOBER, 1913

On my way over from Europe, I dictated hastily some further thoughts concerning the Owen-Glass Bill.

I dissected the rediscount clause, which I believe ought to be amended in several respects, and I also added a few figures and thoughts concerning the note-issuing clause, in which I believe the interest charge ought to be omitted at all hazards.

I do not want to touch upon the questions that I have already covered in my article recently published, but I would like to add a few thoughts concerning the control of the Federal Reserve Board.

I have carefully examined again the organization of the various European central banks, and I find that in none of the important central banks, excepting that of Russia, is there any direct government influence upon the bank management. It is true that in the majority of countries, the government appoints the governor and vice governor. With these coöperate, either in official capacity, or in advisory capacity, the bankers and business men.

In the Banque de France we find a governor, appointed by the government, and the directors, appointed by the 200 largest shareholders. The governor cannot act without authority of the board, but the board cannot act without the signature of the governor.

A very large number of central banks have a board of censors, which acts as a board of supervision and coöperates in voting upon certain questions. In Germany, instead of having a board of censors, there is a Kuratorium, which is composed of government officials, but this body meets only four times a year, and has no direct influence upon the management of the bank. On the whole, the principle is generally adhered to, although there are slight differences in details, of having three powers, the first, the

supervisory, the second, the executive, appointed by the government, and the third, a directorate, appointed by the stockholders, representing the banking and business people. I should think that this well-tried modus should give us a valuable lead for the United States.

If the heads of, let us say, the four Federal reserve banks, who would be appointed by the President from lists to be submitted by the Federal reserve banks, became members of the Federal Reserve Board (and there might be added some additional members appointed by the President), there would then be a Board which would be able to perform its functions effectively, because from each part of the country, banking knowledge and knowledge of existing conditions would be contributed. It could then be stipulated that the Board cannot act without the approval of the governor, and vice versa.

If there should be a tie vote, the Board of Supervision would have the decisive vote and this Board of Supervision would be constituted by the Secretary of the Treasury and additional members appointed by the President. The Federal Reserve Board would deal with the routine matters of the general running of the business. All larger questions, such as the working out of rules and regulations, schedules, etc., would have to be dealt with by the Federal Reserve Board and the Board of Supervision, acting together as a general council. This, too, is a modus not infrequently applied by the European central banks. If this suggestion were followed, the consequence would be that normally the government would be kept out of the general business, that it would only have the power of supervision and that, only in case of a tie vote, the government would have the duty to take an active part in the management of the business.

In following this modus, the political requirements would be met, because every member of these boards would have been appointed by the government. At the same time, while the government would be protected, the business community would be satisfied.

The modus as here suggested, would most closely approach that of the Dutch government bank and the Belgian government bank, which are model institutions, and it would also be in harmony with the principles employed by the Banque de France.

It might be well worth while to consider whether this Board of Supervision, which would represent the government, and which would be composed exclusively of government officials, or members to be appointed by the President, might not be made the instrument for the issuance and control of the currency of the Federal reserve banks. If these notes were made the direct obligation of the joint Federal reserve banks, their issuance might, nevertheless, lie in the hands of this Board of Supervision, which would give it the desired government control and color. If to this be added the guarantee of the government (though I do not consider this necessary), the political requirements of the case would be fully met, while we would escape the principle so much criticised by experts and social economists, of letting the government issue these notes as its primary obligation.

Rediscount Clause

The first two lines of Section 14 read as follows: "That *any* Federal reserve bank may receive from *any* member bank deposits of current funds, etc., or checks, etc."

We may assume that it is not the intention that a member bank in Pensacola may deposit current funds with a Federal reserve bank in Oregon, but that it is intended that any Federal reserve bank may receive from any "*of its*" member banks deposits, etc. This ought to be made clear, but there are other points that require further investigation. (It would greatly further the understanding and the discussion of the problem if the framers of the law gave a rough outline of their conception of the future system, giving the names of the cities where head offices and where branches are expected to be established. But, let us assume that there will be between sixty and seventy.) The System cannot possibly work if *any* member bank may rediscount notes and bills of exchange with *any* Federal reserve bank. (line 10.) Each member bank must only have dealings with the *branch* to which it has been allotted, and with the head office only, if it should be situated in, or allotted to, a central point. Otherwise all control would be lost and the greatest confusion would ensue. Each member bank must deal only with the office of the Federal reserve bank to which it belongs, and through it with the other branches

or head offices. This applies equally to transfers to be made from accounts of member banks to those of other member banks in other cities.

Section 14, lines 3 and 10, ought to be amended in this respect but, in addition, lines 6 and 9 ought to be changed. As the bill reads now, a Federal reserve bank or branch could not receive or send for collection maturing bills which had been discounted some time previous. This is a serious defect and the paragraph ought to be amended to read as follows:

> or a Federal reserve bank may receive *from other Federal reserve banks and from its own branches, and branches may receive from other branches of their district and from their own Federal reserve bank,* for exchange purposes, *or for collection,* deposits of current funds in lawful money, national bank notes, or checks and drafts upon solvent banks payable on presentation *and maturing bills. All of such drafts, checks, or bills to be payable in the district of such Federal bank or branch.*

It is provided (line 25, page 24) that notes and bills of exchange admitted to discount, must have a maturity of not more than 90 days; the subsequent paragraph permits the discounting of paper having a maturity of even up to *120 days.* No limit is set for the aggregate amount that each member bank may rediscount, and there is room for apprehension that some banks in some districts, where money would be high and scarce, might do a pretty active turn by granting 90 days credits, and immediately rediscounting these bills with the Federal reserve bank.

Normally the Federal reserve bank ought to receive only the short maturities and, unless there is to be set a limit for each bank to the rediscounting of paper with only one banking signature, it might be advisable to provide for the *possibility* of different bank rates for different maturities. To illustrate, let us say 5 per cent for up to 30 days, 5½ per cent for up to 60 days, 6 per cent for up to 90 days, and so on. I do not suggest that these rates *must* differ at all times but, in order to keep down some over-active banks or districts, without punishing those at the same time that are moderate in their demands, it might be most advisable to provide in the law for the possibility of such differentiation.

In dealing with the right of discounting bank acceptances, the latter are limited to transactions based on the exportation and importation of goods, while a maturity of up to six months has been allowed. The first restriction appears too narrow, the latter too generous. There may be a few trades for which six-month acceptances are required, and there is no reason why American banks or bankers should not accept such bills, but it is not necessary that these bills should immediately be rediscounted by the Federal reserve banks. European central banks generally restrict their purchases to 90-day paper, the principle being that central banks must remain liquid and invest only in quickly maturing assets. Paper that is longer than 90 days is being purchased by the general banks and becomes available for rediscount when it has "run off" to 90 days. The rate for six-month paper would naturally be very different from the 90-day rate. I would suggest therefore to restrict the privilege to discount bank acceptances to paper not exceeding a maturity of 90 days. I also believe that "importation and exportation" is too narrow a field for bank acceptances. Wherever the purchase of a commercial note is legitimate, a bank acceptance would be legitimate just as well.

Commercial paper, that is temporary accommodation, must be placed only to provide for a temporary phase in business or production, not for permanent investment, in plant, etc. That is the main rule for any temporary accommodation, be it single-name paper or bank acceptance. Some writers argue (for instance, Mr. Untermyer) that only goods *sold* should be considered a legitimate basis for commercial paper and rediscount, because the fact of their being sold would guarantee consumption of the goods, and thereby automatic liquidation of the bill, as it matures. That is not correct. If the cotton grower sells his cotton to Mr. A. and against this sale draws his 90-day bill on Mr. A., that does not ensure the consumption of the cotton in 90 days. If Mr. A. is a speculative gentleman, he may have accumulated a much larger quantity than can be absorbed by that time, and even if Mr. A. is a bona fide dealer, or spinner, it will take longer than 90 days till the cotton will be transformed into the final article, which will be consumed by the public. We might find hundreds of illustrations of this kind, whether we follow silk, copper, coffee,

hides, or other articles. An iron-clad rule or definition cannot be given, but the sound judgment of the banker and the business man must play an important rôle in passing on each case. Thus the banker must scrutinize whether his customer's commitments have remained within a certain proportion to the latter's available own means, and the size of these risks must again be judged in the light of their quality, which differs in the various lines of business. Again there is the question whether the article produced is one that, if necessary, can always be disposed of in the market, or one of slow sale. It is perfectly legitimate for a packer, tanner, spinner, or weaver, having paid for his plant with his own money, to call on his bankers to accommodate him for the carrying of merchandise in course of production. If, however, he asks for a credit out of proportion to his own means, or for sums so large as to give evidence of unduly large stocks, which are subject to market fluctuations, he will hurt his credit, and the banker will hesitate or withdraw. No iron-clad rule can be worked out to solve this problem. Only business experience can, and the Federal reserve bank must see its safety in the guarantee of the endorsing or accepting bank, and in the information which it can readily receive by inquiries and examinations.

One ought to be careful therefore not to attempt to define too closely the nature of bills or bank acceptances admissible for rediscount; too many elements enter into each case that cannot possibly be covered. I think that restricting bank acceptances to exportation and importation is drawing too close a line. Why should a shipment from Canada be a legitimate basis for a bank acceptance, while a shipment of apples from Oregon, going through the Panama Canal to Boston, might not be financed by an American bank acceptance? Europe finances shipments that never touch Europe—should we be barred by law from doing the same? If a packer may sell his 90-day note for $100,000 to the First National Bank of Chicago, may not the First National Bank rather give its own acceptance instead? In the one case it earns its commission for accepting, in the other, for endorsing the paper; the risk is the same. I should think that the line to be drawn between endorsed bills and acceptances is of a very delicate nature, and I should venture to suggest that following the words

"exportation and importation," there be inserted the words "transportation and production" of goods. Business experience will then develop the correct standard as it has in Europe.

I should further suggest that lines 17 and 18 be stricken out. They provide that "the amount so discounted (being bank acceptances) shall at no time exceed one-half the capital stock of the *bank for which the rediscounts are made.*" This is most decidedly a mistake. If the National City Bank of New York accepts the $100,000 due in 90 days, drawn on it by Messrs. Sugar of Cuba, the bill being sent to New York to the Fourth National Bank, and the latter endorses it to the Federal reserve bank, there is no reason why the Fourth National Bank should be charged with the liability on the books of the Federal reserve bank. The National City Bank, having accepted the bill, has become responsible for its payment. It is against the acceptor that the limit has to be figured, or the first endorsing bank, in case of a promissory note. The bank or bankers' acceptance, provided it commands confidence, without which it would not be taken, eliminates the commercial risk as far as any further purchasers of the bill is concerned, and it is passed on and endorsed frequently by a great many additional holders, on an interest basis, without taking into consideration any possibility of loss of capital. The compensation for the latter risk is earned by the acceptor or the first endorser, in case of a promissory note. Inasmuch as the law provides already that the amount which member banks may accept must not exceed one-half of their capital, lines 17 and 18 may safely be eliminated.

The last lines of this Section 14 ought to be amended. They now read: No association shall at any time be indebted . . . to an amount exceeding the amount of its capital stock . . . except on account of . . . liabilities incurred under the provisions of Sections Two, Five, and Fourteen of the Federal Reserve Act.

As I read these sections, if any member bank endorsed a promissory note to the *Federal reserve bank*, it would not count as indebtedness. If, however, a member bank endorsed a bill to another member bank, or to anybody else, it would in the meaning of the law be construed as an indebtedness.

This would mean that no discount market could develop, because every bank would rediscount with the Federal reserve bank, and would rediscount with any European or American banker only as a last resort. This is, of course, just the reverse of what should be intended. The system will work only if a free discount market develops, and only a fraction of the amounts rediscounted in normal times are sent to the Federal reserve bank.

Open Market Operations, Section 15

It would appear that in line 5 "or foreign banks" ought to be left out; that after "prime bankers' bills," there should be inserted in line 6 "bearing at least three signatures of good standing, including that of the acceptor," and before "bills of exchange" the word "foreign," and in line 7, the words "for rediscount." (It is not clear what this clause means.)

It certainly should not be permissible for the Federal reserve banks to buy promissory notes without the endorsement of member banks. If it is meant that the Federal reserve banks may purchase from private firms, with their additional endorsement, promissory notes, bearing already the prescribed endorsement of member banks, it ought to be stated clearly. As the clause reads now, it is in contradiction to the last clause of Section 16.

In this connection it might be well to point out that the large European central banks do not buy in the open market at the private discount rate (as stated by Mr. Untermyer), but that they purchase their paper, which must have two to three signatures, at the bank rate from their depositors. The rate of the discount market, the private discount rate, is normally substantially lower than the bank rate, and the central bank secures, at its higher rate, the short maturities which are not good delivery in the open market. In the latter, only first class paper—either bank or bankers' acceptances, or endorsed by banks or bankers—is accepted at the private rate. Mr. Untermyer's suggestion of letting the Federal reserve banks buy in the open market would, if carried out, destroy the bank rate as distinct from the private rate and, leaving aside the grave dangers that would follow direct dealings between Federal reserve banks and private con-

cerns, it would, by eliminating the banks as endorsers and as discounters, destroy the possibility of developing standard banking paper and a discount market.

We might at this point touch upon the last clause of Section 17, which provides that every Federal reserve bank (and branch) shall accept *at par* checks drawn upon any other Federal reserve bank (and branch ?) and that transfers of funds should be made *at par* among Federal reserve banks and branches. Great care must be taken that this clause may not lead to abuse. The Reichsbank charges a minimum of five days' interest at the bank rate for the collection of checks, payable at cities other than that where the check is handed in for collection. The Federal reserve bank's fee for collection ought to be equivalent to at least the number of days' interest, at the bank rate, which it would take the check to travel to the point of collection, and the collected funds to return to the point from which the check started. This would not allow for clerical expenses, postage, etc., so that an extra day might be added.

The details of such a schedule, governing each point, would have to be worked out by the Federal reserve banks, but the principle ought to be recognized that, while it is the object of the organization to break down for good and ever, any gold premium between various points, and to reduce to a legitimate charge the collection fees between the various cities, the charges of these Federal reserve banks must not be less than cost and a very small profit, covering the expenses of the organization. Nobody may require that he be served without paying a reasonable compensation. If the rate for short money is lower than the Federal reserve bank's bank rate, a good deal of the collection business will be done by the banks, because they might be glad to purchase and collect a check, and thereby invest their funds, at 3½ per cent for five days when, conceivably, the bank rate might be 4 or 4½ per cent. But that should be so, because in times of easy money the Federal reserve bank must attempt to withdraw its funds from active use and prepare for harder times. It is a mistake—and a very grave one—to say that the result of the perfection of a Federal reserve bank system will be to stimulate trade, or to keep rates low. It is when rates are low and money goes begging that

commitments are being entered into that bring about the collapse. It is the duty of the Federal reserve bank to counteract, as far as it can, periods of unreasonably low rates and, by working against overstimulation and by accumulating funds in times of plethora, to prevent extreme rates and catastrophes in times of scarcity. *If the Federal reserve bank destroyed the regular business of the banks, if it did not make it a rule that for normal rates it would be higher, but for abnormal rates it would be lower than the banks, it could not perform its function.* If the Federal Reserve Bank of New York every day of the year were willing to receive funds in New York, and pay the same day in San Francisco at par, without any charge, or pay cash at once against a check on San Francisco, without figuring or charging interest, and vice versa (no matter which way the balance would have to be remitted), and if this principle were applied to all collections and transfers, the funds of the Federal reserve banks would rapidly be absorbed, because the untold millions of collections would be thrown into the Federal reserve banks, which would do this business at a loss.

This rule must apply to collections, transfers, and discounts—or the Federal reserve banks will be at all times the most active of all banks, while their most important function ought to be to remain, at times, as inactive as they possibly can.

Great benefits will accrue to the country, even though the Federal reserve bank may remain comparatively inactive, through the very existence of the System, its greater flexibility, its greater safety, and the greater influx of European money, provided always that this system will command the confidence of the world's banking community.

To return to Clause 15 (Open Market Operations), Clause B ought to be amended so that, excepting securities of the United States, investments should be permitted in short-term notes only, possibly no longer than for nine months or a year, of States, counties, and municipalities. The reason for this we have dwelt upon already. The Federal reserve banks should own only assets of reasonably short maturities; moreover, it would open the door to political pressure and abuse, if each community tried to have its securities placed with the Federal reserve banks. Europe's practice bears out this point of view.

Taking Senator Owen's basis of balances with Federal reserve banks, there would be available (in million dollars):

From country banks.....	157	
From reserve city banks.....	94	
From central reserve city banks...	70	
	321,	to which would have to be added 50 per cent of the amounts which might be held either in vault or as balances.
	104	
	$425	for simplicity's sake we shall call it $420,000,000.

The opening balance sheet then would be as below:

Capital	100			
Balances	420			
Treasury	150			
	670	against which there would be (as a guess)		
		Discounts	150	
		Cash	520	
			670	
Capital	100	Cash	520	
Balances	420	Discounts and		
Treasury	150	Bonds for exchange	850	
Notes issued	700			
	1370		1370	

Each year 5 per cent of the national bank notes will be assumed and the status will change each year accordingly; after 20 years it will look as follows (provided no other changes had happened during that time): that is, 520 cash against a liability of 1270 being 40 per cent, which is very low and an increase in the note issue of only 290 millions would bring the Federal reserve bank to the limit of its power of accommodation. Actual gold withdrawals of only 100 millions would have the same effect.

Now, while this illustration is extreme, inasmuch as capital, balances, and consequently cash, will have grown very substantially in twenty years, we must not forget that on the other hand circulation requirements will have increased very materially, while we have left note circulation unchanged at its present figure.

The illustration shows, however, what we shall have to beware of. It leads towards two conclusions: the first is the importance of including in the item of "Discounts and Bonds" those 350 millions of one-year Treasury notes, which will ensure a certain flexibility and safety and, second, the importance of increasing the item "cash."

If we suppose that the Federal reserve banks will have succeeded in twenty years in substituting their own notes to the extent of $500,000,000 for the gold certificates or gold in circulation, or that they will have acquired gold from other quarters to that extent, the balance sheet will look as follows:

Capital	100	Cash	1020	This means 1020 cash against 1770 liabilities, that is, *about 60 per cent;* the note issue could be increased by 1290 (against 290) and gold could be withdrawn to the extent of 430 (against 100) before the 32 per cent limit would be reached.
Balances	420	Discounts	}	
Treasury	150	Bonds	}	
Notes issued	1200	Foreign Exchange	850	
	1870		1870	

The strength of the future structure will depend on the amount of gold it will control. If, for each note that it will put out, it will have to pay interest, be it only ½ per cent—the minimum prescribed by the law—this attempt will be thwarted. If there is to be a tax, it must be on the deficiency in the gold cover, but not on the accumulation of gold.

It is for this reason that there must be no charges for the "advances" of notes.

The question whether the notes are to be made payable in gold or in lawful money has been much discussed. If the notes are to be obligations of the United States, they must be paid in gold. It would not do to make one obligation of the United States payable by another obligation of the United States (like the greenbacks) or silver certificates. That would create endless confusion

and apprehension. If the notes are to be the joint obligations of the Federal reserve banks, they might be made payable in gold certificates and greenbacks; but in that case it is suggested that the surplus earnings of the Federal reserve banks be used for annually increasing the gold cover behind the greenbacks. The funded debt of the United States is very low per capita and there is no reason for reducing it by these surplus earnings. On the other hand, if the latter were employed as here suggested, we would secure a tremendously strong and undoubted gold currency as the basis for our banking system, while the silver notes in small denominations would become absorbed by the people. If we disfranchised the greenbacks entirely, we would lose the benefit of the $150,000,000 gold which partly secure them; it would be better to fructify them by gradually strengthening their gold cover, as here proposed.

P. M. W.

APPENDIX SEVENTEEN

SUGGESTIONS FOR AMENDING SECTIONS FOURTEEN AND FIFTEEN OF THE FEDERAL RESERVE BILL

Powers of Federal Reserve Banks

Sec. 14. *Any Federal reserve branch bank (there being a branch also at the Federal reserve bank points for the carrying out of the local business) may receive from any of* ITS MEMBER BANKS AND FROM THE UNITED STATES[1] *for collection or deposit, current funds in lawful money, national bank notes, Federal reserve notes, or checks, drafts, and maturing bills payable at any point in the United States where there will be a Federal branch; or from other Federal reserve branches, deposits of current funds in lawful money, national bank notes, or checks and drafts and maturing bills payable in its branch district.*

Upon the endorsement of any of its member banks, any Federal reserve bank may discount notes, drafts, and bills of exchange arising out of actual commercial transactions; that is, notes, drafts, and bills of exchange issued or drawn for agricultural, industrial, or commercial purposes, or the proceeds of which have been used, or are to be used, for such purposes, the Federal Reserve Board to have the right to determine or define the character of the paper thus eligible for discount, within the meaning of this Act. Nothing in this Act contained shall be construed to prohibit such notes, drafts, and bills of exchange, secured by staple agricultural products, or other goods, wares, or merchandise from being eligible for such discount; but such definition shall not include notes, drafts, or bills covering merely investments or issued or drawn for the purpose of carrying or trading in stocks, bonds, or other investment securities, except bonds and notes of the government of the United States. Notes, drafts, and bills admitted to discount under the terms of this paragraph must have a maturity at the time of discount of not more than ninety days.[2]

[1] This change was adopted in the Federal Reserve Act.

[2] Note that my draft omits the power given to Federal reserve banks in the Glass Bill to discount paper having a maturity of more than 90 days and not

Any Federal reserve bank may discount acceptances of member banks which are based on the exportation or importation or domestic shipments of goods and *which have a maturity at time of discount of not more than three months*,[1] and bear the signature of at least one member bank in addition to that of the acceptor.

The aggregate of such notes and bills bearing the signature or endorsement of any one person, company, firm, or corporation rediscounted for any one bank shall at no time exceed 10 per centum of the unimpaired capital and surplus of said bank; but this restriction shall not apply to the discount of bills of exchange, drawn in good faith against actually existing values.

Balance of clause unchanged.

Open-Market Operations

Sec. 15. Any Federal reserve bank may, under rules and regulations prescribed by the Federal Reserve Board, purchase and sell in the open market, at home or abroad, either from or to domestic or foreign banks, firms, corporations, or individuals, cable transfers and bankers' acceptances and bills of exchange of the kinds and maturities by this Act made eligible for rediscount, "*such bankers' acceptances and bills of exchange bearing the endorsement of one member bank*" (should this be added or is this to be left as to be covered by the "rules and regulations?")

Every Federal reserve bank shall have power:

Clause (a) remains unchanged; (b) to buy and sell, at home or abroad, bonds and notes of the United States, and bills, notes, revenue bonds, and warrants with a maturity from date of purchase of not exceeding *nine* months,[2] issued in anticipation of the collection of taxes or in anticipation of the receipt of assured revenues by any State, county, district, or municipality of the United States, *and notes or obligations payable in gold of European States or munici-*

more than 120 days. The Federal Reserve Act as finally adopted follows the lines of my draft.

[1] This change was adopted in the Federal Reserve Act; the Glass Bill had provided for acceptances "which mature in not more than six months."

[2] The Glass Bill had given power "to invest in United States bonds and bonds issued by any State, county, district, or municipality." The Federal Reserve Act provides for "warrants with a maturity of not exceeding six months of any State, county, etc. . . ."

palities, with a maturity from the date of purchase of not exceeding nine months, such purchases to be made in accordance with rules and regulations prescribed by the Federal Reserve Board; (c) *to purchase through its branches from member banks, and to sell with or without its endorsement checks, drafts, and bills of exchange payable in foreign countries; but such bills of exchange must arise out of commercial transactions and must have not exceeding ninety days to run and must bear the signatures of three or more responsible parties, one of which shall be that of a member bank.*

Clause (d) remains unchanged; (e) to establish accounts with other Federal reserve banks for exchange purposes and, with the consent of the Federal Reserve Board, to open and maintain banking accounts in foreign countries, appoint correspondents *to act as agents in* such countries wheresoever it may deem best for the purpose of purchasing, selling, and collecting bills of exchange, and to buy and sell with or without its endorsement, through such correspondents or agencies, bills of exchange arising out of actual commercial transactions which have not more than ninety days to run and which bear the signature of *three or* more responsible parties.

The following to be taken out of Section 17, and placed after Section 14.

The Federal Reserve Board shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among Federal reserve banks and their branches, and may at its discretion exercise the functions of a clearing house for such Federal reserve banks, or may designate a Federal reserve bank to exercise such functions, and may also require each such bank to exercise the functions of a clearing house for its member banks.

Nothing herein contained shall be construed as prohibiting a member bank from making reasonable charges *for receiving, collecting, or remitting checks, drafts, and current funds* or for exchange sold to its patrons. The Federal Reserve Board may, by rule, fix the charges to be collected by the member banks from its patrons whose checks are cleared through the Federal reserve bank and the charge which may be imposed for the service of clearing or collection rendered by the Federal reserve bank.

P. M. W.

APPENDIX EIGHTEEN

THE EDUCATIONAL CAMPAIGN FOR BANKING REFORM, BY A. D. WELTON [1]

. . . In June, 1912, came the great national conventions. . . . The League's publication said that banking reform "is a political question only so far as its solution requires political attention in the highest sense of the term. There is no chance that a Democratic scheme of reform will be better than a Republican scheme because it is offered by Democrats, or that a Republican scheme will be superior because it is offered by Republicans. In banking methods neither party is at an advantage over the other because banking is not a matter related to their differing conceptions of popular government."

Committed to banking reform and not to politics or party, the League's purpose was to keep, so far as possible, the question from assuming a partisan aspect. . . .

Enunciation of Fundamental Principles

In September, 1912, the League stated the principles it believed should underlie a banking bill. The statement gave as the reasons for banking reform:

To prevent the recurrence of money panics.

To provide for seasonal and special demands for currency and credit.

To insure more uniform and steady interest rates throughout the country.

To divorce commercial from investment banking.

To strengthen our international credit.

To establish higher standards of banking.

It is remarkable, perhaps, in the light of current discussions that in 1912, *Banking Reform* said:

[1] From the *Annals of the American Academy of Political and Social Science*, January, 1922, Vol. XCIX, No. 188.

The National Citizens' League believes that these reforms in our banking and currency system can be best brought about by the formation of a coöperative association of all classes of commercial banks, with restricted powers, managed by a board of bankers, Federal officials, and other citizens. The association should not be a money-making institution and all earnings beyond a fixed rate should go to the National Treasury. This association should:

Hold the final banking reserves.

Act as fiscal agent of the government.

Rediscount standardized commercial paper for banks at published rates of discount uniform over the country.

Issue circulating notes secured by gold and commercial paper.

Deal in gold and foreign exchange.

Establish foreign agencies.

It must be remembered that this statement was made two months before Woodrow Wilson was elected President and eight months before Congress began to debate the Glass Bill.

The League's principles were carefully drawn very early in the campaign. They took no account of partisanship, except to guard against it, as generally befitted an organization of business men bent on securing an economic reform. The principles were:

1. Coöperation, not dominant centralization, of all banks by an evolution out of our clearing-house experiences.

2. Protection of the credit system of the country from the domination of any group of financial or political interests.

3. Independence of the individual banks, national or state, and uniform treatment in discounts and rates to all banks, large or small.

4. Provisions for making liquid the sound commercial paper of all the banks, either in the form of credits or bank notes redeemable in gold or lawful money. Legalization of acceptances and time bills of exchange in order to create a discount market at home and abroad.

5. Elasticity of currency and credit in times of seasonal demands and stringencies, with full protection against overexpansion.

6. The organization of better banking facilities with other countries to aid in the extension of our foreign trade. . . .

Attitude of Bankers and Other Organizations

Bankers and bankers' organizations were always helpful and friendly. They were never keen for the League's principles and, as a rule, they were collectively and individually more interested in the probable effects of any change in laws on their established method of operation. In this respect they often clashed with the business men whom the League represented but they always admitted the need of change in the banking scheme.

As the campaign progressed, other forces came in to give assistance and often to interfere. Usually these organizations made plans. Of plans for a new banking system there was a myriad. They came up from all sides. Everyone seemed to have a plan. The League never had one. In that lay its strength.

In September, 1912, Woodrow Wilson spoke of the need for a new banking law in his address accepting the Democratic nomination for the presidency. Soon after his election, and that of a Democratic House and Senate, it became obvious that banking reform legislation would be a Democratic action. . . .

During this period of many hearings by the banking and currency committees the publicity was continued as actively as ever. As the League was concerned only with principles, and not with administrative forms, its printed matter gave no heed to the latter except for informative purposes. . . .

When the Glass Bill had passed the House, it became apparent that the League's work was nearly done. It had undertaken only to lay a foundation for legislative action. It is true its organization work had been carried into practically every Congressional district. The gospel of banking reform was carried most effectively to every Congressman from his home. But when the Glass Bill had become the Glass-Owen Bill and the Senate had it under consideration, the League began to wind up its affairs.

Close of the Campaign

In the last issue of *Banking Reform*, October, 1913, it was said:

The League never undertook to participate in the actual work of legislation. Article 2 of the certificate of incorporation reads:

The object for which it is formed is to give organized expression

to the growing public sentiment in favor of, and to carry on a campaign of education for, an improved banking system for the United States of America.

Of the success of the League's campaign there is no doubt. It is evidenced by the fact that for more than two years the question of monetary reform has been growing in the public mind until to-day it is the question of paramount political as well as economic importance. It has occupied the latter position for many years, but it was not until the League's work was well under way that it was lifted out of classification with the impenetrable mysteries to that of a great, and finally the paramount, public issue. One Congressman reduced the situation to terse form when he said, "No League, no bill."

The League has distributed literally millions of pamphlets. It has been the means of supplying literally millions of columns of matter to newspapers. It has supplied speakers for thousands of meetings. But the indirect results of its efforts have been more momentous. It brought interest in the question of monetary science to an acute stage. It challenged every argument founded on a false conception of monetary economics. It supplied material which made editorial work easier. It translated technicalities into simple language. It stimulated thought and discussion. It freed thousands from the thraldom of half a century of false teaching.

The fact that the Glass Bill is not perfectly satisfying is in nowise attributable to failure on the League's part. It has been stated many times in these columns that the machinery by whose operation the principles enunciated were to be given operation might assume any one of many forms. The Monetary Commission evolved one form, the Glass Committee evolved another. Neither is perfect in anticipated operation. It is doubtful if any machinery will be perfect until made over after practical test. But either plan has obvious merits and forms a basis on which can be built up an operating success.

The Executive Committee of the League feels, therefore, that the work of the organization has been practically completed and success has been achieved. It will retain its corporate entity and maintain its organization intact against possible contingencies until results are written in the statute books. But unless the

unexpected happens, the League will rest content that the question of banking reform and its satisfactory solution is in the hands of the national legislature. Over this body it has no control, and seeks none, as it has had none anywhere save what was based on logic and built up on adherence to proved principles of monetary economics.

As a final testimony of the efficiency of the League's campaign, it may be pertinent to record that the terse statement, "No League, no bill," was made by the Honorable Carter Glass.

APPENDIX NINETEEN

EXHIBITS ON PENDING LEGISLATION

LETTER FROM IRVING T. BUSH

New York, August 7th, 1913

My Dear Mr. Warburg:

I received this morning your letter of July 26th, with accompanying pamphlet concerning the Owen-Glass Bill. I have read the pamphlet with interest and it is, as is always the case with any statement prepared by you, clear and direct.

The bill, as originally introduced, has been changed in so many ways as to be hardly recognized. The changes, in my opinion, have been nearly all for the better, and I am coming to the conclusion that the Owen-Glass Bill in its present form is a very much better measure than any of us expected would be introduced.

I will send you with this a copy of reprint of the bill in its latest form and also a copy of the report of the Currency Committee of the Chamber of Commerce of the United States of America, upon the bill in its original form. You will notice that most of our suggestions were adopted.

I should like to see less cash carried in the vaults of the local banks, and more carried with the Federal reserve banks. I also feel very strongly that the number of Federal reserve banks should be reduced.

I have been to Washington twice within the last month—once to attend the meeting of the Currency Committee of the Chamber of Commerce of the U. S. A., and on Monday of this week, to confer with Mr. Glass, Senator Owen, and Secretary McAdoo, in company with Mr. Farwell, and four or five other representatives of the National Citizens' League, each one from a different part of the country.

I am impressed with the fact that the gentlemen with whom we conferred are most anxious to produce a good bill, and to listen to suggestions upon any point, except that of control. They have definitely decided that the Central Reserve Board must be

appointed by the President. They have adopted our suggestion of an Advisory Federal Council which I personally believe will be quite effective. An ordinary Advisory Board is of little use, chiefly because the members have no selfish interest, and pay little attention to their duties. In this case, the Federal Advisory Council will be composed of men who are directly responsible to the regional banks. Their opinion will carry great weight, because of their position, and they will have sufficient selfish interest to be always on their job. With the present temper of the American people, I should rather have a government-appointed Board, if I were a banker, than a Board composed entirely of bankers, or a mixed Board. It is out of the question to expect the country to accept the principle of a Board composed of bankers. The people will not put into the hands of men, who make a profit from dealing in money and currency, the control of issuing currency. If the Board consists of nine members, as was originally suggested, six appointed by the President, and three bankers, public suspicion will always be directed against the appointed members who might vote with the bankers, where a difference of opinion arose upon important questions.

In theory, the control of the Federal Reserve Board is general. In practice, the real banking operations of the country will be carried on under the direction of the officers and directors of the Federal reserve banks, and the Federal Reserve Board will only exercise control upon certain fundamental questions involving public welfare. I believe it is better not to have a divided responsibility, but to have full responsibility put up to a government-appointed Board, after they have heard the advice of direct representatives of the banks.

It will take too long for me to attempt to express my views upon the various sections of the bill and they will probably not be of particular interest to you, as the reprint of the bill will tell its own story.

There has been enormous pressure brought to bear upon Mr. Glass and Senator Owen, to introduce all kinds of absurd provisions, and it has required a great deal of tact and determination to withstand this pressure, and produce a bill as good as the Glass-Owen Bill in its present form.

Mr. Glass recognized at once the desirability of reducing the number of Federal reserve banks, when we urged that point very strongly, our idea being at first that we should start with Federal reserve banks only in central reserve cities, and should gradually increase the number, after the System was in working order, and as it became necessary. Our thought was not only that a System of from three to five banks would be more effective, but the present location of reserves would be less disturbed, if we began only with central reserve cities. Mr. Glass stated that in the beginning Mr. Bryan wanted fifty Federal reserve banks, and it was only after heroic work that the number has been reduced to twelve.

The present method providing for issuing Federal reserve notes is also a compromise. Mr. Glass recognizes, as do others who are interested in the bill, that the Federal reserve notes are really bank notes, and that the government is merely the issuing agent. They are to be redeemed primarily by money furnished by the Federal reserve banks. The statement that they "purport" to be an obligation of the government is to satisfy the radicals. You will remember that I have always argued that public interest would only concern itself with the question of control. The bill, in its present form is, I believe, not unsatisfactory to bankers. Mr. Reynolds, of Chicago, has stated to Mr. Farwell that he would go into it, and this statement was made even before a number of recent changes which have improved the bill. Many of the bankers are making long arguments against "political control." I have already expressed myself upon that point. Their statements are so general that uninformed people receive the impression that a band of politicians are to have control of all of the banking machinery of the country. In my opinion, with the management of the Federal reserve banks in the hands of the bankers, we can rely upon our experience with the Supreme Court and the Interstate Commerce Commission to guide us in securing a competent Federal Board.

I have asked your secretary to send me some additional copies of your pamphlet, and I am going to send one to Mr. Glass, Senator Owen, Mr. McAdoo, and President Wilson, as well as to a number of men who are interested in the problem.

I, personally, feel that the bill is so nearly good that criticism, at the present time, should be confined to helpful suggestions. I feel that if you were here, and could talk with Mr. Glass and Senator Owen, you would modify some of your criticism, although your whole pamphlet is most tactfully written.

So much is being said by the banks against the method of control, and so many statements are being made, which seem to me to be misleading, that I believe it is time for those who are interested in currency reform to help the present measure, instead of criticizing it.

Mr. Glass states that he has had a terrible ordeal, fighting against what he calls "Corn Tassel Currency." The bill in its present form will, in all probability, be sent to the House from the Democratic Caucus, and will be put through the House as a party measure. Its sponsors will, I believe, not accept even good suggestions in the House, for there are so many wild-eyed radicals in that body that, if the door is once opened by accepting a good amendment, there is no knowing where a stop can be made. The opportunity for further change will come either in the Senate, or in the Conference Committee. Mr. Glass is really a conservative, and he will undoubtedly be a member of the Conference Committee, and helpful.

I hope when you see the bill in its present form, that you will decide that the best thing to do is to help in every way its passage, and to wait until the bill reaches the Senate, and is ready for criticism.

I should like to discuss many other features of the bill, but I have not the time, and I am sure you have not the patience.

With best wishes, I am,

Yours very truly,

IRVING T. BUSH

P. S. Mr. Fisher is away until September.

LETTER TO IRVING T. BUSH

Hamburg, Germany,
September 1st, 1913

DEAR MR. BUSH:

A great many thanks for your kind letter of August 7th and enclosure. I read your lines with the greatest interest and profit. I fully realize Mr. Glass's difficulties, but if the "long haired ones" bring pressure upon him to do things that are unreasonable we must continue to bring pressure to do things that are reasonable. I fear that if we cease to press from our side the other fellows will have a walk-over. The bill, as it stands now, is still a very miserable patchwork. If those suggestions that we are working for would be adopted, it might become quite a decent and useful measure. With twelve Federal reserve banks it will fail. I have recast my article bringing it up to date and, I believe, improving it (for which there was room). I wonder how the *Journal of Commerce* came to print some of it? I would have preferred not to see published a part of it, but only the entire argument. But no great harm is done. I shall have a copy of the revised article sent to you. Whether the notes are called United States notes or Federal reserve notes is in itself not of fatal consequence. But the charging of interest on these "advances" is a serious matter, and the structure, as it stands, prevents a comprehensive and safe plan for the taking over of the national bank-note issue and the 2 per cent bonds. I agree with you that we should not criticize but help by suggestions. That is what I am trying to do. As to the mixed Board, I do not agree with you. Let the government appoint it, but there must be some bankers and the others must be permanent fixtures, but not "in and outers" and politicians like the Cabinet ministers. I have tried to stress that in the revised wisdom contained in my article. Thank you again and excuse my bothering you with this.

With kindest regards and best wishes,

Sincerely yours,

PAUL M. WARBURG

Irving T. Bush, Esq.,
Chairman, Committee on Currency,
Merchants' Association of New York, New York, N. Y.

LETTER FROM EDMUND D. FISHER

On July 10th, 1913, Mr. Edmund D. Fisher, who shared honors with Mr. Bush as one of the most active members of the New York Committee of the Citizens' League, wrote to me as follows:

City of New York

Department of Finance

July 10th, 1913

My Dear Mr. Warburg:

You may be interested to learn that there was a meeting of the Currency Committee of the Chamber of Commerce of the United States in Washington yesterday.

I attended the three sessions which were held and, I think, was able to do some effective work, although, naturally, a meeting of such a group from all over the country resulted in some compromises. The attitude of the meeting was to accept the general spirit of the bill and confine suggestions merely to constructive amendments. In a general way the recommended changes were as follows:

(1) That the Board of seven as planned, instead of including two officers in the first instance, appointed by the President, should choose two officers—a governor and vice governor, who should automatically become members of the Board, subject to the approval of the President. This makes a Board of nine.

It is believed that the choice of officers would thus have a better quality of consideration, and as their salaries will be fixed by the Board, opportunity given to choose the best men in the country available for the purpose.

In addition to the Federal Reserve Board, there should be organized a Federal Reserve Council consisting of representatives chosen by the directors of each of the Federal reserve banks. This body, in turn, should elect a president and vice president who should be resident at Washington and sit at all meetings of the Federal Reserve Board, although without vote. It was felt

that their work would be more effective without the vote, as they would represent the banking and business interests of the country and following the line of the German practice and precedent their judgment would usually prevail.

(2) That the principle for the issue of Federal Treasury notes be changed and that Federal reserve notes be issued, although guaranteed by the government. To make this guarantee logical it was further suggested that a fund be developed from the surplus earnings of the Federal reserve banks, that should be applied—first, to reimburse the government for losses, if any, that might come through the failure of any Federal reserve bank. After a reasonable fund had been thus provided, that the further surplus earnings be applied to buy up any demand obligations of the government ("greenbacks").

(3) A strong argument was made that the arbitrary number of twelve Federal reserve banks established at one time could be the cause of confusion and be dangerous. It was, therefore, suggested that at first there be only organized Federal reserve banks in the present central reserve cities, and that if later the Federal Reserve Board felt it wise to organize additional banks, that could be done at convenience and grow out of presumed necessities.

There were, of course, numbers of important as well as minor suggestions, all trending toward efficiency and sound banking and business practice. I think the report will be promulgated on about the 14th of this month.

I have ceased sending you material from the papers as there is now very little of importance and the period of thrashing out details has been definitely initiated.

I think the sponsors of the measure have receded from their first inflexible position that they had an ideal bill, and are inclined to welcome constructive criticism. They will not depart, however, from the general principle of Federal control.

I expect to take my vacation during the month of August, and presume you will be in New York upon my return.

Cordially yours,

EDMUND D. FISHER

Mr. Glass has accepted suggestion 1, the others have not yet been submitted to him.

EXCERPTS FROM A LETTER OF PROF. J. LAURENCE LAUGHLIN OF OCT. 15, 1913

I am deeply obliged to you for your thoughtfulness in sending me from Hamburg a copy of your *North American* article.

I am interested to note that you, almost alone among the bankers, believe that the Federal Reserve Board should have power to compel another reserve bank to discount for any one reserve bank.

While this ought to be permissive, I am in doubt whether it ought to be made mandatory.

Of course, I am also in agreement with you in thinking that twelve Federal reserve banks are too many.

I believe that when the Senate finishes with the bill, it is likely to be improved in several particulars. I am optimistic enough to think, in its final outcome, we shall have a fairly satisfactory measure; but, of course, no one need expect an ideal thing under the present conditions of American legislation.

NATIONAL ASSOCIATION OF CREDIT MEN

Office of the Secretary-Treasurer
41 Park Row

New York, Jan. 7th, 1913

Mr. Paul M. Warburg,
Kuhn, Loeb & Co.,
52 William Street,
New York, N. Y.

Dear Mr. Warburg:

Upon the suggestion of Mr. D. G. Endy of Philadelphia, Chairman of our National Committee on Banking and Currency, I am pleased to hand you enclosed five copies of our "Banking and Currency Leaflet No. 1." *This is the leaflet which you so kindly assisted us to definitely formulate, and it is already creating thoughtful attention.*

We hope very soon to have it in the hands of the very largest number of our commercial men throughout the country, and if

you can use a few additional copies to advantage I shall be delighted to supply them.

Sincerely yours,
J. H. Tregoe
Secretary-Treasurer

NATIONAL ASSOCIATION OF CREDIT MEN

Office of the Secretary-Treasurer
41 Park Row

New York, January 10th, 1913

Mr. Paul M. Warburg,
Kuhn, Loeb & Co.,
New York, N. Y.

Dear Mr. Warburg:

I thought it might interest you to know that yesterday our National Committee on Banking and Currency had a conference with the House Subcommittee, of which Hon. Carter Glass is Chairman. Ours was the only commercial association so far interviewed by this Committee to present ideas upon a new and adequate banking and currency system, and I personally thought that but a short time would be accorded us for this work.

We appear, however, to have interested Mr. Glass and his associates very deeply, and the conference lasted from 11:30 in the morning until 5 in the afternoon, excluding merely one hour for luncheon. During that period we were severely grilled, especially myself, but, fortunately, no entanglements occurred, and we adhered strictly to certain fundamental principles which our Committee believed were absolutely necessary in any new adequate banking and currency system.

Each member of the Committee, also representatives of the press, were furnished with a copy of the "Banking and Currency Leaflet No. 1" [1] and altogether, the serious nature of our work

[1] Reproduction of Leaflet No. 1 will be found on pages 697 to 699.

led Mr. Glass and his Committee to solicit our good offices in promoting a mutuality of effort in securing a proper reform. I personally feel that every effort should now be directed upon the Committee to incorporate a central institution of some character which for political reasons merely, as I take it, the Committee is disinclined to do.

Yours very truly,

J. H. Tregoe
Secretary-Treasurer

EXCERPTS FROM REPORT ON ALDRICH BILL BY THE BANKING AND CURRENCY COMMITTEE, NATIONAL ASSOCIATION OF CREDIT MEN, JUNE, 1912

. . . Fitting and important as the work for better State banking laws is, your committee in making its plans, felt that the time had come when the members of the Association should be encouraged to grapple with questions touching currency and national banking reforms, in order to make themselves factors in eliminating, so far as possible, the weaknesses and danger spots in our present system.

Therefore, through special letters to our members, and particularly to officers of local associations, your committee has worked to arouse an intelligent interest, first by calling attention to the strictly non-partisan efforts being made by the "National Citizens' League for the Promotion of a Sound Banking and Currency System," and second, by calling upon credit men to bring to their meetings leaders in the theory and practice of banking men who could help the members in forming solid conclusions. As those who have read the *Bulletin* month by month know, there has been a very general response to the committee's efforts, and it is quite evident that our members have to-day a far more intelligent understanding of the causes of banking and currency breakdowns

and of the elements we must introduce to prevent them, than ever before.

Your committee has been most careful not to prejudice members, and particularly banking and currency committees of local associations, either for or against the proposals of the National Monetary Commission. It urged that conclusions, whether reached by members or those outside the organization, especially if they be adverse to the Monetary Commission's Plan, be called to your committee's attention. The result has been that several local associations have gone into the proposals with such care as to be justified in adopting resolutions, some emphatically endorsing the Monetary Commission's Plan, others giving their endorsement to the general plan, but suggesting amendments thereto, and in two instances, we believe, our local associations have taken adverse positions with reference to the Commission's Plan, though freely acknowledging the weaknesses of our present system.

Deserving of special notice in this connection is the work of the Banking and Currency Committee of the Philadelphia association, under whose able chairman, Mr. D. G. Endy, several committee conferences were held, in which the plan and bill drawn up by the Monetary Commission were gone into section by section, and each given unqualified approval, or else suggestions for changes were made. Mr. Endy's committee was made up of representatives of the strongest banking, manufacturing, and mercantile houses in Philadelphia, and to this body of men your committee is especially indebted for suggestions.

It is the purpose of your committee here briefly to take up the report of the National Monetary Commission, and offer suggestions for changes in certain sections, which we hope may meet the approval of this convention.

It is not necessary more than to refer to the weaknesses inherent in the present system which the Monetary Commission has endeavored to meet—lack of elasticity both in our currency and credit systems; scattered reserves absolutely preventing free cooperative action among banks in times of stress; assets not usable when most needed during any season; no scientific connection between banking power and the government.

The plan evolved by the Commission is not new. It is not a central bank that is proposed, but an agency of all the banks, and an agency that keeps in touch through well organized local district boards and a widely chosen central board, with commercial and banking needs in all parts of the country. It would do business only with its constituent members and the government. It would pay no interest on deposits, would loan no money except to and through its constituent banks. It would not be a new bank set down in our midst and destined through competitive branches to absorb or crush out existing banks but merely a mechanism which will permit the banks to coöperate for the good of each and all, and to perform those natural functions of banks which they are now prevented from performing, to the disadvantage of our commerce.

To begin with, your committee, after a careful study, reached the conviction that the National Reserve Association, with its local associations and branches established under the powers and limitations provided in the Monetary Commission's Bill, is, in general, well conceived and would overcome, in the main, the fundamental weaknesses of the present system; that as a system it is sound, scientific, workable, and adapted to the requirements of the country.

RECOMMENDATIONS FOR CHANGES IN PLAN OF NATIONAL MONETARY COMMISSION

There is not time, nor is it necessary here to describe the organization of the Reserve Association, but there are a few suggestions which your committee would like to see incorporated into the bill now before Congress to establish a National Reserve Association, which suggestions, your committee hopes may receive the approval of the convention.

Section 5 provides that fifteen cities in the United States shall be selected for the location of branches of the National Reserve Association. Your committee, after a careful study, concluded that with but fifteen branches there would be many financial cities, centers of important commercial activities, strictly entitled to act as branch cities, which would have to be ruled out in the allotment of branch headquarters, and believing that these branch

headquarters should come as close to the people as possible and be quite accessible, your committee urges that instead of fifteen there be twenty-five branches.

Coupled with the change in Section 5, there must be a corresponding change in Section 9, which states the basis of directorship in the board of the National Reserve Association. Instead of fifteen directors, one elected by the board of each branch, there would be twenty-five directors so elected, and for the same reason, twenty-five directors in that class which the boards of directors of the branches elect to represent the agricultural, commercial, and industrial interests of the various districts, and perhaps also a slight increase in the number of directors elected by voting representatives chosen by the branch boards on the basis of the number of shares held in the National Reserve Association.

Section 10 provides that the governor of the National Reserve Association shall be selected by the President of the United States and hold office for a term of ten years. Your committee believes that it would be wise to reduce this term at least in the beginning to five or at the outside to six years, and that the terms of the deputy governors be for the same period as the shortened term of the governor.

Section 14 provides for an executive committee of the National Reserve Association of but nine members, of which the governor, the two deputy governors, and the Comptroller of the Currency shall be members *ex officio*, leaving but five to be elected from the elective representatives on the board. Your committee feels that this very important committee should be made larger, but is not prepared to name the exact number to which it should be increased.

Your committee concurs with the Banking and Currency Committee of the Philadelphia association, in urging that there be a change in Section 21 of the Monetary Commission's Bill, so that instead of making it optional with local associations to assume and exercise the powers and functions of a clearing house, the law shall make it mandatory upon them to do so, for the committee feels that the plan of a National Reserve Association should carry with it large facilities for the clearance of checks and drafts covering

each local association district. In order that the actual cost of making collections and the loss of time incident thereto may be brought down to a minimum, our recommendation accords with that of the Philadelphia committee that a section be incorporated in the act providing for the establishment of clearing houses within all the proposed fifteen or twenty-five branch districts—whichever number of branch districts is finally decided upon—for the purpose of clearing drafts and checks drawn upon all towns and cities in the district, and that an additional clearance plan be worked out whereby all the branch district clearing houses shall interchange and make collections and settle balances between separate districts, these clearing houses to be operated as a part of the National Reserve Association Plan.

Your committee also recommends that Section 58, by which Congress reserves the right to alter or amend the provisions of the act, same to take effect at the end of any decennial period from and after the organization of the National Reserve Association, shall be amended by changing the word "decennial" to "quinquennial," giving a five instead of a ten year period in which to make amendments effective.

Opposition has been expressed in some quarters to the plan for a National Reserve Association on the ground, as objectors say, that powers of immense influence for good or evil—powers that belong to the government itself—are centered in an extremely small body, namely, the executive committee of the Reserve Association. We appreciate the basis of the opposition, but have confidence that the government as represented by the President would be as successful in making safe appointments to the high offices of governor of the National Reserve Association and Comptroller of the Currency, as successive Presidents have been almost without exception in the case of Supreme Court judges. We have faith that the President could and would secure from the banking fraternity men of ability, honor, judgment, and experience, who have as high ideals of service which they might render through appointment to the highest banking office in the land, as the members of the bar have in aspiring to the highest places on the bench.

Referring to the governor and members of his executive com-

mittee, some seem to think that abuse must follow authority, but while authority implies power to abuse, none of us are pessimistic enough to say that such abuse follows the granting of authority to any extent, and all will agree that abuse of authority is much less likely if the authority is fixed and definite and secure and open.

Our purpose in recommending a larger executive committee than that proposed in the bill is not that the public will have greater confidence in the larger committee's right purpose, but because we want that committee to be as representative as possible, and yet not be too large to be workable.

In conclusion, your committee offers the following resolutions:

I

"*Resolved*, That it is the sense of this Association that with the approach of another legislative year, the Banking and Currency Committee renew its demand for strong banking laws in the various States, and especially for a separate and distinct banking department with ample authority in every State in which the laws provide no such department.

II

"*Resolved*, That the National Association of Credit Men, in convention assembled, views with satisfaction the many evidences of deep interest taken by its members during the past year in a study of methods of bringing our national banking and currency system more nearly into accord with the needs of our expanding commerce, and be it further

"*Resolved*, That as credit men we are keenly sensible of the perplexing and intricate task which has been discharged by the National Monetary Commission and its able advisors, and express the belief that the bill presented by the National Monetary Commission in its report made to Congress under date of January 9th, 1912, presents in general a safe, sound, scientific method for overcoming the serious defects of our banking and currency system, and that a measure based closely upon the bill offered by the National Monetary Commission should be taken up seriously in Congress and pushed to enactment, and be it further

"*Resolved*, That the incoming Banking and Currency Committee be instructed to use its influence to introduce into legislation, based upon the Commission's report,

(1) Provision for the establishment at least of twenty-five branches of a National Reserve Association, instead of fifteen.
(2) Provision for a corresponding increase in the number of directors of the Reserve Association.
(3) Provision that the term of the governor of the National Reserve Association be not more than five, or at the outside six years, and of the deputy governor a like length of term.
(4) Provision that the executive committee of the Reserve Association be made more broadly representative than is cited in the proposed measure by increasing the size of membership.
(5) That provision be made to put into effect alterations and amendments to the act at the end of five instead of ten year periods.

III

"*Whereas*, it will mean much to the commerce of the country if the actual cost of making collections on drafts and checks and the loss of time incident thereto, may be brought down to a minimum, a step as we believe, as vital to the commercial community as a cheap and efficient mail service, therefore be it

"*Resolved*, That this Association endeavor to have made mandatory in any act for monetary and banking reform built upon the proposals of the National Monetary Commission, the establishment of clearing houses within all districts for the distinct purpose of clearing drafts and checks drawn upon all towns and cities in a district, and that an additional clearance plan be worked out whereby the district clearing houses shall interchange and make collections and settle balances between the central districts, these clearing houses to be operated in conjunction with the National Reserve Association of America and its branches, and be it further

"*Resolved*, That all checks drawn by bank depositors on any

bank within a particular district shall in bold type bear the number of that district, in order to facilitate quick handling."

Respectfully submitted,

WM. INGLE
H. S. KEATING
W. A. PETZOLD
E. D. PLUMMER
J. H. KING, *Chairman*

EXCERPTS FROM A FOREWORD ON THE ATTITUDE OF THE NATIONAL ASSOCIATION OF CREDIT MEN TOWARD BANKING AND CURRENCY REFORM, OCTOBER, 1912

COMMITTEE'S SPECIAL LETTER TO THE MEMBERSHIP

The American Bankers' Association has held its annual meeting without committing itself to any plan on banking and currency reform.

The new president of that association strongly supported the Monetary Commission's Bill now before Congress, and there was an effort made to pledge his association to it, but it seemed wise to the Currency Commission of the American Bankers' Association not to take such definite action, but work for reforms in conjunction with other forces.

In the preface of a volume recently issued by the National Citizens' League, devoted to the advancement of the cause of banking reform, it is said, and truthfully, that not since the Civil War has the country been confronted with a monetary and banking situation of greater importance than we are facing to-day, brought about by a development which has exposed again and again the inadequacy of the present system, but in spite of this fact, not only is Congress turning aside from any consideration of the subject, but there is no outward sign that any considerable part of the public are thinking seriously of it. Strangest of all, the banking interests themselves, with the exception of a few individuals in each of the larger banking centers, appear to be unconcerned and without opinions, either as to the plan which has been submitted to Congress, or any other.

It is difficult to arouse popular interest in a matter having such technical phases as a banking and currency system. The average depositor, either in a savings or a checking institution, has little knowledge of his bank, but he must have faith in it and in its administration, primarily faith in the latter.

The appeal to the people for interest in banking reform should be made on this basis, and the first step is to generate some interest on the part of the bankers themselves, not organically but individually, for they hold the confidence of their depositors, and can, if they will, be leaders in forming a substantial backing for any wise and safe system of reform.

It is perhaps to be regretted that the Bankers' Association failed to take a more definite stand on this important question. Yet on the other hand, the fact that the bankers have shown lukewarmness in this matter is the strongest argument against the attitude of the men who are conspicuous in the movement to repudiate the plan of the National Monetary Commission on the ground that it is a scheme to bind the banks of the country under legal sanction into one great incorporated money trust.

The broad-minded and public-spirited citizen, be he banker or business man, can always be relied upon to support any proper system, not because it will favor the bankers, but because it will favor the business public. Bankers as a rule are in a position to take care of themselves in times of stress, in protecting their own interests, but they do so because of the system provided by law necessarily at the expense of the business men of the country. Well conducted banks as a rule are making money, despite the obsolete and inadequate system under which they are operating, but in the final analysis the business public are the sufferers. It would, therefore, appear that the great common people are much more vitally concerned in this reform than the bankers. This question is national in its scope, affecting as it does the entire population of our great country, and it will devolve upon us, the people, to present a united front, and use all the force in our power to promote the passage of proper legislation.

The National Association of Credit Men with its thoroughly organized and highly developed affiliated branches in every distributing center of importance throughout the United States, must

be among the leaders in bringing to a successful issue this important reform.

The Banking and Currency Committee of the Association therefore earnestly requests that every man interested in credits inform himself as fully as possible on a subject which is likely to affect so vitally the business he is every day engaged in. Carefully read the report and resolutions of the Banking and Currency Committee, read the bill itself incorporated in the report, and make a critical and personal analysis of its features. (Send to the National Office for copies.)

The National Association of Credit Men, ever on the alert to advocate correct principles, has been conservative, perhaps ultra-conservative; it has withheld its endorsement of any plan for monetary reform until a proper solution has been found. Last year's Committee on Banking and Currency, after careful and painstaking consideration of the bill now before Congress and after making suggestions and recommendations which they believe should be incorporated in a bill, has given its approval, the Boston Convention unanimously adopted their report and resolutions and the Association now stands committed to support the measure.

The incoming Committee appeals to the members of the Association to give them all the aid possible in the performance of their arduous duties.

We repeat, let the one thing needful be done, namely, an individual study of the National Monetary Commission's measure throughout the Association. Do not condemn and do not accept it without giving it that painstaking thought to which it is entitled both from the viewpoint of your own business and the commercial interests of all the people.

D. G. Endy, *Chairman*

Why the Existing Banking and Monetary System of the United States Retards Commerce and is a Menace to Every Business Man

Banking and Currency Leaflet
No. 1

The Existing Banking and Monetary System of the United States Retards Commerce and is a Menace to Every Business Man

BECAUSE of its inflexible and immobile system of bank reserves, there can be no centralization of banking resources to meet an unusual pressure or strain, with the result, as experience proves, that during the past sixty years there have been recurring panics more or less violent, but always exacting from business a heavy toll.

Because of this inflexibility and the very large number of our independent banking institutions, there is, in panic periods, a disposition upon the part of each to strengthen its own position by the hoarding of funds, the contraction of loans and the withdrawal of that support to legitimate business which is so necessary in these periods of quick and dangerous readjustment.

Because it was solely an emergency measure with no adequate

provisions for elasticity of plan to provide for the ebb and flow in business and to meet successfully the strains upon the public confidence, such as always precede banking and business disturbances.

Because currency secured by the public debt as represented by government bonds is influenced more by the market value of the bonds than by the real needs of business and the currency requirements to finance large crop movements or other emergencies. A currency limited by the public debt, controlled by the availability of the bonds securing it, may tend to inflation in periods of inactive business and limited currency demand and become dangerously inadequate in periods of activity and strain because no more currency can be issued than there are bonds upon the market available for currency issue purposes.

Because it makes no provision for a fixed and reliable market for discounting or rediscounting at reasonable rates, at all times, high grade commercial paper, a vitally necessary condition in making it

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possible for business men to convert their sales into a marketable liquid asset in order legitimately to meet the necessities of a safely increasing business.

Because it fails to legalize acceptances, which are a convenient and sound form of commercial paper, especially in the development of our international trading.

Because it attracts the flow of banking funds into central reserve cities, where it is largely loaned by the banks on call upon fixed capital or stock exchange securities, thus encouraging speculation to the prejudice at important times of agriculture and commerce.

Because there is no provision for the encouragement of international trade by the establishment in foreign cities of American banking houses upon an adequate and sound basis or any provision whereby the nation's stock of gold may be mobilized, increased, or protected when international balances may be against us.

Because our financial history compares unfavorably with that of England and the commercial na-

5

tions of the Continent, not only in deficiency of methods provided for the protection of commercial credits, but in that our government, through its treasury system, withdraws funds from the ordinary channels of trade. Our treasury and sub-treasury system is not only unsound in theory, but unsafe and burdensome in practice, for by it lawful funds are withheld from their natural uses, and in one administrative officer is alone reposed the discretion of placing these funds at the public's service, or withholding them, no matter what the need or strain may be.

Because the system was strictly a war measure, with no provision or thought of fostering national commerce and because of its inflexibility and other defects, the whole system has become a constant menace to every progressive business man.

National Association of Credit Men

41 Park Row, New York, N. Y.

Banking and Currency Committee

D. G. ENDY, CHAIRMAN
Artman-Treichler Co., Philadelphia, Pa.

CHAS. D. JOYCE
A. Colburn Co., Philadelphia, Pa.

O. J. SANDS
American National Bank, Richmond, Va.

A. H. DECATUR
Decatur & Hopkins Co., Boston, Mass.

G. W. WHITE
National Metropolitan Bank, Washington, D. C.

APPENDIX TWENTY

PART OF A MEMORANDUM SUBMITTED TO THE FEDERAL RESERVE BOARD AT THE BOARD MEETING OF DECEMBER 3, 1915

The policy to be pursued by Federal reserve banks must be guided exclusively by the public interest.

Federal reserve banks must neither fail to carry out transactions and exercise functions—which otherwise would redound to the benefit of the country—for the mere reason that they entail heavy expense or loss; nor must they, on the other hand, conclude transactions and exercise functions on account of the earnings to be derived, in case these transactions or functions would run counter to the public interest, or would lessen the ultimate ability of the Federal reserve banks to render the largest service for the general benefit of the country.

In carrying out their policy they must neither compete for the sake of competition nor not compete for the sake of avoiding competition. In carrying out functions with which they are charged by the law they must compete or not compete as the public interest requires.

If we agree on this premise, we must then ask ourselves, in what way do Federal reserve banks serve the public interest?

The function of Federal reserve banks is to provide a safe system of banking (free from our heretofore periodical collapses) and more stable and equal interest rates than we have had in the past.

Broadly speaking, the problem of banking may be summed up in the following quotation:

> "If banks were to keep, in cash, all the money deposited with them, business would come to a standstill and a crisis would ensue. If banks were to lend indiscriminately to those who apply for loans all the money on deposit with them, a general panic and collapse would follow a short period of

overstimulation. Between these two extremes lies the middle course, the finding of which is the problem, and its practice the art of banking."

To find and preserve this middle course is the particular function of the Federal Reserve Bank System.

The present maximum lending power of the entire Federal Reserve System is about $600,000,000. The total loans and investments by national banks amount at present to about $8,000,000,000; those of the state banks to $7,500,000,000. It is obvious that it cannot possibly be the object of the Federal Reserve System, by competition, to substitute a lending power of $600,000,000 for that of all the banks of the country, amounting to $15,500,000,000. The aim of the System must rather be to keep this gigantic structure of loans and investments, which is largely carried by bank deposits, from overexpanding so that, as the natural and inevitable result, it may not be forced to overcontract and, conversely, to avoid overcontraction with all its hardships and the inevitably resulting overexpansion.

Effectively to deal with the fluctuations of so gigantic a structure is a vast undertaking for which the resources of the Federal Reserve System are none too large at this time. If the task is to be accomplished successfully, it cannot be done by operations which are continuous and of equal force at all times, but only by carrying out a very definite policy of not only employing funds vigorously at certain times but, with equal vigor, not to employ funds at others. That during periods of actual employment the Federal reserve banks will make large earnings and that during periods where a restricted activity of Federal reserve banks is rendered necessary by general conditions, their earnings should be smaller, are incidents which have no bearing upon the measure of their usefulness. Federal reserve banks, when accumulating funds, are exercising as useful a function as when they are employing the same. If safety and stabilization of rates form the soundest foundation for general prosperity, everything that the Federal reserve banks do in avoiding excessive rates, both too high and too low, redounds to the benefit of the nation, and the mere fact of the general confidence in this stability and the knowledge that

funds are in reserve and available brings about the freest use of credit facilities at liberal rates all over the country. If the potential or actual employment of $600,000,000 can have this effect upon loans and investments of $15,500,000,000 (of which $12,500,000,000 are loans and discounts) the usefulness of the Federal Reserve System has been proven. That does not mean that when once we shall have passed through a period of active money we shall ever have to contemplate conditions where the entire funds of the Federal reserve banks will lie idle. A certain proportion will always remain in active service, and there will be no doubt about their ability to earn their running expenses or that, when once they occupy their proper field of operations—and averaging their operations over a reasonable period—they will earn their dividends, but time must be given them for this.

If Federal reserve banks should find permanent difficulty in earning their dividends, remedy must not be sought by improperly using their funds but rather by carefully investigating whether or not organic defects exist which might be overcome. We must not forget, on the one hand, that the capitalization of the bank and the prescribed rates of dividends are arbitrarily fixed and that experience only can demonstrate whether or not these are properly chosen. Personally, I am inclined to think that they are about right provided, however, that the Federal reserve banks are given the same powers as enjoyed by the European central banks with respect to the note issue. The weakness of the System, as at present devised, is that, unlike the European central banks, they cannot derive their chief profit from the note circulation. In Europe, the Banque de France, the Bank of England, the Reichsbank and the other central banks have substantially a monopoly of the note issue, and balances with these central banks and their notes are considered as cash by the banks of the country. (The Bank of the Netherlands has a capital of 20,000,000 florins and a note circulation of 300,000,000 to 400,000,000 florins.)

Our difficulty is a threefold one: first, we have a note-issuing power superimposed upon an inelastic currency issued to the limit of what the country can absorb; second, our notes are not counted as reserves, the consequence of which is that, at times, like the present, when additional currency for actual circulation is not

required, we do not pay for our investments by the issue of Federal reserve notes but by a loss of gold; and third, that our inability to issue notes against gold, or gold and commercial paper, prevents us from broadening and strengthening our banking power. At present we are tied down to the maximum of the deposits of the member banks. Gold deposited for redemption purposes with Federal reserve agents is a most desirable and powerful protection in case of gold withdrawals. It does not add, however, any additional banking power. It replaces but does not add. The vicious effect of these conditions is that we cannot deal boldly with the problem of government bonds and the circulation secured by them. If we could increase our own free stock of gold, that question could be solved and, with that, the problem of our earnings.

I make free to submit a memorandum suggesting how it can be done, and apologize for the rough form of all statements, which have been dictated hurriedly without regard to form.

It is proposed to amend Section 16, clause (2) to read as follows:

> "Any Federal reserve bank may make application to the local Federal reserve agent for such amount of the Federal reserve notes hereinbefore provided as it may require. Such application should be accompanied by a tender to the local Federal reserve agent of collateral in amount equal to the sum of the Federal reserve notes thus applied for and issued pursuant to such application. *The collateral security thus offered shall be gold or gold certificates and notes and bills accepted for rediscount under the provisions of Section 13 or purchased under the provisions of Section 14 of this Act. Whenever the gold deposited as collateral with the Federal reserve agent shall be less than 40 per cent of the aggregate amount of the aggregate collateral deposited, the Federal Reserve Board shall establish a graduated tax*," *etc.*

The force of this amendment would be that Federal reserve notes could be exchanged for gold and that the gold so accumulated would become the free asset of the Federal reserve banks. As the law stands to-day the gold that accumulates against the issue of Federal reserve notes accumulates in the redemption fund deposited with the Federal reserve agent and ceases to be the property of the

Federal reserve banks. It cannot serve as a basis for additional loans, but it renders only a service—though a most important one—in being available in case of gold withdrawals. The consequence is that at present the Federal reserve banks are limited in their growth to the amount of obligatory balances of member banks with Federal reserve banks. While the optional balances may be deposited, it is not safe to count on them.

If the law should be amended as here suggested, every note holder in the country would become an additional depositor of the Federal reserve banks and he would become a permanent depositor, because it is safe to say that the amount of gold certificates carried in the pockets of the people at this time would be permanently carried in Federal reserve notes. It is safe to expect that the Federal reserve banks would be strengthened by several hundred million dollars of gold in this manner. If three hundred millions were added this would mean an additional loaning power of 450 million dollars.

The far-reaching effect of this process would be that the Federal reserve banks thus strengthened could afford to deal on a broad basis with the question of government bonds and Federal reserve notes. At present Federal reserve banks are disinclined—and correctly so—to adopt a policy of purchasing hundreds of millions of government bonds and issue against them Federal reserve bank notes as long as the gold supply which they command is not larger than it is now. While it is true that they need only maintain a reserve of 5 per cent against these Federal reserve bank notes, it is equally true that these notes may be presented at any time for payment in gold and that, from the point of view of the Federal reserve banks, a 5 per cent gold reserve would be insufficient. If notes could be exchanged freely for gold, the additional loaning power which would accrue to the Federal reserve banks by the accumulation of additional gold, could be used to provide the necessary gold reserve against a large amount of Federal reserve bank notes.

A very interesting suggestion has been made to the Board (by Mr. Perrin) to the effect that any national bank, the charter of which would expire, should receive a renewal charter only upon the condition that its power to issue notes against government

bonds should cease; but that the Federal reserve banks should purchase the government bonds of these banks at par at the expiration of the bank's charter. In this manner, all the government bonds would fall into the hands of the Federal reserve banks within twenty years. A portion of these bonds would doubtless be disposed of in the market as government 3 per cent bonds and the Federal Reserve Board and the Federal reserve banks would have to decide what portion they wished to carry as one-year notes and what portion as 2 per cent government bonds against which notes could be issued.

If this plan were carried out, the inelastic government secured currency would be made elastic by the Federal reserve banks, because it would be in their power to issue these notes at times when there would be legitimate requirement for increased circulation and to withdraw them from circulation at other times. Furthermore, the question of earnings of Federal reserve banks would be solved, because the larger the note issue of the banks, the larger would become their revenue. This revenue would be derived from the government bonds, and the more government bonds would be disposed of to the public, the more important would become the commercial business of the Federal reserve banks, because if we take it that a certain amount of currency is required and a large portion of this currency can only be issued against the collateral of commercial paper, this commercial paper must go to the Federal reserve banks. Of course, if Federal reserve notes should be made available for reserve money of member banks (not of Federal reserve banks, as so many people appear to think when the question was discussed in past years!), this process would take place with so much more effect. There is no doubt that Federal reserve banks will not find their ultimate and proper place until Federal reserve notes receive reserve qualities. At present we have the anomalous condition that the gold that comes into this country, which should accumulate in Federal reserve banks, accumulates in member banks, while the gold holdings of the Federal reserve banks hardly have grown except where the amount of the additional reserve payments had to be made under the law. We furthermore have the anomalous condition that at this time when there is no demand for additional circulation, any investment

the Federal reserve banks make is being paid for not by Federal reserve notes, but by a loss of gold.

While it is most gratifying to see that the bankers who so violently opposed as unsound any thought of counting Federal reserve notes as reserve, are now of their own accord coming around to the opposite view, it still may be that Congress would not yet be prepared for such a step. In that case it might be more advisable to proceed slowly and to ask at this time only for the amendment as above outlined.

My own suggestion would be to increase the gold cover from 40 per cent to 60 per cent and begin to tax at 60 per cent, though beginning only with a very low tax and increasing only very gradually, increasing more rapidly when the gold cover falls below 40 per cent. The effect, however, would be that Congress and the country would see that it is expected normally to have a gold cover in excess of 60 per cent rather than in excess of 40 per cent and while we would expect to issue more Federal reserve notes in this case, we would, on the other hand, expect to issue them normally on a higher basis of gold protection. This effort may ultimately be helpful in persuading Congress to permit these notes to be counted as reserves. As it is now, there is no room for an elastic note issue, for our elasticity has been tied to a frayed rubber band which is already stretched to the limit—the Federal reserve banks have no power of contracting under the present structure. As above stated, nothing will help Federal reserve banks more in finding their proper position and in securing sufficient earnings, without being forced to use their reserve money in a way which at times would be unsafe and improper, than an effective and sound note-issuing power.

P. M. W.

APPENDIX TWENTY-ONE

LETTER TO HON. CARTER GLASS

New York, N. Y.
February 29th, 1916

DEAR MR. GLASS:

You have asked me to write, in as plain language as I possibly can put it, the reasons that prompt the Federal Reserve Board in suggesting the amendment to the note-issuing clause. I shall try to comply with your request, but in doing so I shall have to ask your permission to let me be as frank in writing as I have always been in talking to you.

A famous violinist, now dead, once said, "If I do not practice for one day, I notice it; if I do not practice for two days, my friends notice it; and if I do not practice for three days, my enemies."

That is our condition. The Board has been playing the Federal Reserve instrument now for over a year. We know the beauties of our instrument but we also ought to know by now where it needs strengthening.

Some of our members appear to think that whoever criticises the Act, acts as an enemy. I have no patience with that view. I am a most enthusiastic supporter of the Federal Reserve idea, but because I wish it to succeed I think it my duty to point to shortcomings that have developed, some of which nobody could foresee, some of which could not be avoided if at the time legislation was to be secured; but shortcomings all the same, that, if not removed by the friends of the System, will sooner or later develop a condition of weakness which will be used by the enemies of the System as an evidence of the failure of the whole structure.

While I agree that for the present it will be necessary to ask for such amendments only as may be absolutely necessary, I think it my duty in discussing this matter confidentially with you as between friends, to call a spade a spade, so that we may clearly recognize conditions as they are.

In order to shorten this letter as much as possible and to free it as far as practicable from statistical material, I take the liberty of appending a few tables and statements to which I may refer. I append No. 1 and No. 2, an analysis of the latest report of the Comptroller, showing borrowings by national banks in Federal reserve cities. I further append tables Nos. 3, 4, and 5, showing the amount of money invested by each Federal reserve bank, the amount available for further investment, the percentage of return now secured from all investments, and the amount necessary to be invested at the present rate of return in order to earn the six per cent dividend. I also append statements showing our lending power before and after the proposed amendment—No. 6.

If you will kindly look at statements Nos. 3 and 4, you will find that if all Federal reserve banks invested a sufficient amount in order to earn dividends at the present time, the lending power of some banks would be overdrawn, some would be just exhausted and the free lending power of the entire System would be reduced to $105,000,000, including $15,000,000 government deposits (or to $90,000,000 based upon own resources), of which New York would provide $75,000,000 and Chicago $18,000,000.

But disregarding for the moment all ambition to have all banks earn their dividends, and supposing that we are satisfied (which of course we are not) to have a majority of the Federal reserve banks earn only their running expenses, an examination of the present consolidated status of all Federal reserve banks will show that together they have investments of about $104,000,000; they have a net circulation of Federal reserve notes outstanding of about $11,000,000; so that on balance $93,000,000 of their investments have been paid for in gold. We may disregard the Federal reserve notes against which gold has been deposited with the Federal reserve agents or with the gold clearing fund because, as a matter of fact, this circulation represents at present substitution of one gold certificate for the other. The volume of circulating medium has not been increased by this substitution. The only added circulation that the Federal Reserve System has been able to put out are $11,000,000 of Federal reserve notes. If further investments are to be made—no matter whether they are rediscounts for member banks, purchases of government bonds, war-

rants, bankers' acceptances, or other paper in the open market—under present conditions whatever we purchase would be paid for in gold. It is most important that we keep this one point clearly in our minds, because while we are inclined to take it that the Federal reserve banks provide elasticity and have figured that our original $500,000,000 of gold produce a lending power of—let us say $1,250,000,000, this, as a matter of fact, is nothing but an illusion as long as there is no demand for additional circulation and as long as rediscounting banks—or the seller of whatever we may buy—do not leave with us as idle deposits the proceeds of their sales or take Federal reserve notes in payment. Of course we cannot expect member banks, or sellers in the open market, to rediscount paper with us or to sell us securities, which net them a certain amount of interest return, for the mere purpose of keeping with the Federal reserve banks a free balance which does not earn any return. If a bank sells us $1,000,000 of discounts at 2 per cent, it does so because it requires the proceeds in order to pay some debts. These debts on balance are being paid in the clearing and in the clearing, balances are being settled with gold—not with Federal reserve notes. Federal reserve notes, not being considered as reserve money, could only be taken when there is additional demand for added circulation. But whatever circulation is being required is at present being furnished by the national banks; and, moreover, with the tremendous excess balances carried by almost all banks over and above legal requirements, they will naturally rather pay out currency from their tills than rediscount or resell assets in order to create cash balances which they do not require. This being so, our lending power at present is just as large as our free gold holding, amounting to $240,000,000—that is, about $400,000,000 less the required reserve of 35 per cent on our deposits and 40 per cent on outstanding notes (see statement 6, page IIa).[1] While $240,000,000 is a very large amount, it is a very insignificant figure when we deal with the staggering sums that may constitute balances to be settled between nations, and it is only a fraction of the gigantic total of about $22,000,000,000 of loans and investments that constitute the holdings of all the banks of the

[1] It was thought unnecessary to reprint the supporting statements mentioned in this letter.

United States. To my mind, it is an alarming thought that rediscounts of $240,000,000, or even $384,000,000, as under statement No. 6, page III a, made for the purpose of withdrawing and exporting gold, could wipe out our lending power or bring it down to a degree where a further encroachment upon our reserves would create a panic. And this is our present condition, existing at a time when the banks have barely invested enough to earn their operating expenses. If a sufficient amount to earn dividends should now be invested, rediscount operations for the purpose of withdrawing gold and aggregating $150,000,000 to $250,000,000, would be sufficient to bring us down to the 35 per cent or 40 per cent limit! All of which goes to show that there is too much gold in the pockets of the people and in the vaults of the banks, that there is not enough concentrated in the Federal reserve banks, and that their lending power to-day is not sufficient to give us a feeling of reliance in the strength of the System.

I shall not at this time make an exhaustive argument for vesting Federal reserve notes with legal reserve qualities. As you know, I am profoundly convinced that sooner or later this step will have to be taken and that until we take it the System will be lacking in safety and the country will not be able to derive the fullest measure of benefit from it. Let me say, only, that if at this time Federal reserve notes were counted as reserves, we would have paid for our investments not by substantially $90,000,000 of gold, but by $90,000,000 of Federal reserve notes. We could then have preserved our $90,000,000 of gold—of which we would have had to set aside $36,000,000 (being 40 per cent) as reserve, and we would have retained $54,000,000 as a basis for an issue of $135,000,000 of Federal reserve notes; and in that case we would have been certain that our lending power would have been $135,000,000 and not $54,000,000, because these notes, being legal reserve money, could then be accepted in the clearing. On the other hand, by paying out $90,000,000 of Federal reserve notes *there would not have been any more inflation* (if inflation there is) *than has been caused by our having paid out $90,000,000 in gold. In both cases the same amount of reserve money would have been released by the Federal reserve banks, the only difference being that at present by releasing this amount of money we have crippled our lending power,* while in the

other case we should have reduced it only as to 40 per cent of the amount invested and should have retained 60 per cent as a basis for lending power. It is most important that we get this thought clear in our minds. The effect on the member banks is the same, but the check is on the Federal reserve banks and we must ask ourselves: Did the law intend to provide as *large* as possible a protection for the country as can be created consistently with safety and conservatism, or as *small* a protection as possible? I shall refrain from going further into this argument and from showing the inconsistencies that are involved in denying Federal reserve notes the reserve qualities, but shall rather proceed on the lines that we are set in our minds—for the present at least—not to permit Federal reserve notes as reserve money and that therefore all the more we must see to it that the System be strengthened in every other possible way.

We must ask ourselves, then: How can we strengthen the available gold supply of the System? The Federal reserve banks receive their gold and lending power mainly through their obligatory deposits. (The paid-in capital constitutes only 10 per cent of the resources and will be a smaller percentage when all reserves are paid in.) To these obligatory deposits might be added the optional deposits, but for certain reasons, which it would lead too far to enumerate, these probably will be slow in coming. The stronger the System, the more readily will they come; and therefore, again, as long as Federal reserve notes are not to be counted as reserve money, member banks will hold on to their legal reserve money and twelve smaller banks will inspire less confidence in this respect than eight stronger institutions.

(To my mind it was a mistake to make it obligatory for banks to keep a definite part of their reserves in their vaults. They should have been permitted from the start to keep with their Federal reserve bank any portion of their legal reserves. I still believe that it would be advisable to have the law amended to this effect so that in case of serious conditions the banks could be appealed to to deposit a larger proportion of their vault money in the Federal reserve banks. At present the law does not permit them to go as far as they might wish to in case of general stress, because it forces them to keep their cash tied up in their vaults. It may,

however, be inadvisable to push an amendment of this kind at this time.)

The operations of the last year show that there is a large amount of gold certificates circulating and carried in the pockets of the people which could be assembled in the Federal reserve banks, and Federal reserve notes might be substituted therefor. This has been done to a certain extent during the last year, but the Federal reserve banks in doing so must deposit their gold with the Federal reserve agents in order to reduce their liabilities upon their outstanding Federal reserve notes. The gold thus becomes tied up in a redemption fund and ceases to be the property of the Federal reserve bank. If the gold can be deposited with the Federal reserve agent as collateral, securing the notes just in the same way as notes are secured to-day by commercial paper, Federal reserve banks gradually will gain by that greatly in safety and lending power.

The attached statement (No. 6, page IV b) shows that if we took the gold now deposited with Federal reserve agents and deposited it in the way suggested in the amendment, the lending power of the Federal reserve banks would thereby be at once increased by $85,000,000. In other words, even if we continued to settle in gold for everything we bought, we should at once increase our purchasing power by $85,000,000. If we were dealing with a period where actual circulation were demanded from us, we could issue $848,000,000 (page VI a) instead of $634,000,000 (page III b) on the basis of our present status. Of course, the issue of such a large volume of additional notes is theoretical, except in a period of quite extraordinary conditions; it has, however, an important bearing upon our future development, in case government bonds were converted largely into 3 per cent bonds and disposed of to the public. In that case there would gradually develop a large regular field for the issue of Federal reserve notes against rediscounted paper. The greater importance, however, is the increase in our lending power.

If this amendment were secured, it might probably be expected that the substitution of Federal reserve notes for gold certificates carried in the pockets of the people could be further extended, but there is a strong check on any extreme development in this respect because the moment the issue of Federal reserve notes is overdone

—so that they are not used for actual circulation but go back into the member bank reserves—they are presented for redemption, and inasmuch as it is a very expensive process for the banks to keep these notes out, there will be, after a while, a certain fairly stationary amount of Federal reserve notes that will ultimately be carried in the pockets of the people, beyond which it will be impracticable to go. Let us figure that we would add in this manner $300,000,000 of gold to the holdings of the banks. This would have substantially the same effect as if the deposits of the Federal reserve banks had been increased by that amount, the only difference being that in one case the depositor is a member bank and in the other it is an individual willing to carry a certificate of deposit in his pocket against which there is a 40 per cent gold reserve rather than to insist upon a 100 per cent gold certificate. If the state banks came in or the deposits of our member banks grew to such an extent as to increase our deposits by $300,000,000, thereby correspondingly increasing our lending power, there would not be any discussion or apprehension that this larger amount of gold might constitute a danger of inflation. Why, then, should anybody think that inflation is to be apprehended when our deposits are increased by this amendment through the deposits of individuals?

Incidentally, it may be observed that this is the way the Banque de France and the Reichsbank are constituted, and I believe it is fair to say that England would wish, at the present time, that the Bank of England had been constructed in this same manner.

I believe that we ought to do everything in our power to enable Federal reserve banks to earn a living without depleting their gold reserves. This is one of the steps in that direction. There are certain other developments which, as we go along, will work toward strengthening the Federal reserve banks, such as the payment of the further instalments of the reserve balances and such as the gradual withdrawal of national bank notes. By assuming and redeeming national bank currency, we would create a vacuum which Federal reserve notes may fill. If only we can bring about rapidly enough a reduction of the redundant national bank currency and the sale of a substantial amount of government bonds to the public, thus freeing the Federal reserve banks and

member banks of a certain portion of these bonds, and creating a larger field for a basis of commercial paper against which currency may be required, we would help the solidity and growth of the System. We may be able to submit some helpful thoughts in this respect in the near future. We must bear in mind, however, that, in order to deal boldly with the question of government bonds, Federal reserve banks must be strong, that they cannot afford to buy a hundred million dollars of government bonds unless their gold position is sufficiently strong to protect the currency that may be issued against these bonds; and, moreover, it must be borne in mind that, at present, when they buy government bonds, they pay for them in gold.

Before closing, it may be well to point out that the gold at present deposited with the Federal reserve agent cannot be used by the Federal reserve bank except in the case of gold withdrawals against presentation of Federal reserve notes, in which case it acts as an important protection for the bank. On the other hand, this gold is of no value to the bank with respect to the creation of new lending power. Nor is the gold with the Federal reserve agent of any further use for the purpose of increasing the note-issuing and the lending power of the bank when once the limit of 40 per cent or 35 per cent has been reached (or such other limit as the Board may fix). There may be hundreds of millions of dollars of gold with the Federal reserve agent, but the banks cannot get them out because they have not the necessary assets, and it is to be borne in mind in this respect that this limit is reached much sooner because for each $100 of circulation paid out, it is necessary for the Federal reserve bank to have not 100 per cent but 140 per cent of gold and commercial paper. It is not difficult to perceive that a Federal reserve bank can only go just as far as the uninvested balance of its paid-in capital plus 65 per cent of its deposits will provide forty dollars of gold for each one hundred dollars of notes to be issued. The limit is thus definitely fixed, no matter how much gold the Federal reserve agent may hold, and in order to issue $200,000 in notes there must be assets of $280,000 while, under the new amendment, for each $200,000 of notes there must be assets of $200,000, of which at least $80,000 must be gold. Under the amended plan the above "65 per cent of deposits" may be

increased by the "60 per cent of gold exchanged for notes" and the lending power of the Federal reserve banks increased correspondingly. Illustrations for this are shown on statement No. 6, pages IV c, V d and VI a and b.

I am not unmindful of the fact that present conditions are abnormal and that our normal returns will generally be higher than present rates. But a System like ours must be adaptable to both low and high rates and in any event it must be prepared to meet the demands that the immediate future may have in store for us. What conditions there may be at the end or before the end of the War nobody can foretell, but with the staggering growth of our deposits and loans, with our great ease of money, which with the return of more normal conditions abroad will work as a strong factor in driving out our gold, with the tremendous sums in which adjustments express themselves nowadays—you will agree with me that our present condition is not such as to permit us to neglect any step we may be able to take to strengthen our fences.

Of course, there are several other steps that might be taken in improving our condition, particularly in reducing expenses of operation and increasing earnings. A consolidation of some districts would have a most desirable effect in this and many other respects. A temporary reduction of the paid-in capital might be helpful in some of the districts. A study of tables 1 and 2 tells its own story in this connection.

Some of my colleagues may not be willing to subscribe to everything I have said in this letter and I therefore send it to you as a personal and confidential expression of my views. As I said in the beginning, I have stated them without reserve as between two friends of the System. I should not have said that much if it were a formal report destined for public use.

If there is any further information that you may desire, please call on me freely.

With assurances of highest esteem, I am

Faithfully yours,

Paul M. Warburg

Honorable Carter Glass,
Chairman, Committee on Banking and Currency,
House of Representatives, Washington, D. C.

P.S.

Perhaps I should add one more consideration, and that is that it cannot help impressing us as incongruous that there is no means of guiding a stream of gold (such, for instance, as reaches our country at present) so as to touch directly our Federal reserve banks. As a matter of fact, our System remains at present completely outside of this stream. It fills the member banks and the state banks, but leaves our status unaffected.

If all the gold coming to this country were to flow into the Federal Reserve System, the Federal reserve banks issuing their notes thereagainst, it would strengthen to that extent the basis of our structure, and the larger the amount of gold passing through the System in this manner, the higher would grow the gold cover behind the notes and the deposits, and the smaller would grow the effect of our investments upon our general status. Where two or three hundred millions of investments now form a percentage of about 50 per cent of our assets, it is not beyond the bounds of imagination to think that they should not amount to more than a comparatively modest percentage of our total assets. The amendment proposed is a step in this direction.

May I ask in this connection: Would it be entirely impossible to amend the law so as to place upon the government the cost of printing the Federal reserve notes? When once the Federal reserve banks earn their six per cent dividends there is, of course, no difference whether the United States pays for the printing of the notes or receives so much less in the form of franchise tax but, during the critical and initial periods it would remove a very heavy charge in the budget of the banks. Moreover, the further we develop the issue of Federal reserve notes, as above outlined, the smaller will become the present cost incurred by the United States Government for constantly reissuing its own new circulation. It would thus, in effect, not add any new charge to the government. All questions of earnings and expenses, however, are of lesser importance than the question of safety and lending power, and are mentioned here only for the sake of giving you a somewhat more complete report on the various phases involved in the question.

The appended balance sheet of the Bank of the Netherlands may interest you. You will see that they have a capital and sur-

plus fund of 25,000,000 florins, circulation of 582,000,000 florins and deposits of about 73,000,000 florins. On the other hand, they have cash of 473,000,000 florins. This gives them a metallic cover against notes and deposits of about 72 per cent and, with all that, they have 209,000,000 florins of investments against "own resources" of only 25,000,000 florins.

In this connection we ought not to overlook that our statistics and calculations are on a 40 per cent and 35 per cent basis, but we must bear in mind that these percentages in normal times represent the low-water mark and that even during war times like the present, the European government banks, in spite of the terrible stress to which they have been put, have maintained reserves of around 30 per cent. The normal reserve should be between 60 and 80 per cent, and it will be a very hard task to preserve these percentages and do an adequate business unless the foundation of the structure is broadened.

Faithfully yours,

PAUL M. WARBURG

APPENDIX TWENTY-TWO

QUOTATION FROM *THE CHRONICLE* OF JULY 29, 1916, VOL. 103, P. 348

The Financial Situation

It is difficult to understand the straying away from conservative leanings that is becoming so manifest in the administration of the Federal Reserve banking law and in the recommendations of the Federal Reserve Board for amending the Act. We have several times in the past pointed out serious objections to some of these amendments, but each further step taken by the Reserve Board in unfolding its plans reveals additional proposals of change more incomprehensible and more indefensible than any which have preceded.

In our issue of March 25th, we published the bill originally introduced in the Senate intended to carry out the recommendations of the Reserve Board, and in our issue of June 3rd we printed the bill which Senator Owen on May 24th, on behalf of the Senate Committee on Banking and Currency, had reported as a substitute for the bill passed by the House permitting national banks with a capital and surplus of $1,000,000, to purchase and hold stock in foreign or domestic corporations other than national banks. The House Bill dealt with the single subject referred to, but the Senate substitute embodied all the amendments proposed by the Reserve Board, the language being in some particulars slightly different from that in the original Owen Bill and there being also some entirely new features.

In the Federal Reserve "Bulletin" for July, official responsibility is assumed for the steps taken in Congress. The Reserve Board quotes the paragraphs in its annual report containing its recommendations for amendments and then states that there have been sent to Congress amendments carrying out the recommendations and says these amendments are now pending either in committee or before one of the two Houses of Congress. For the information

of those interested it also prints the text of the measures proposed. This text is identical with that in the Owen substitute for the House Bill already referred to. Until the present week, too, we had supposed that every part of the print of the two bills was the same, but find now that some additional amendments not previously suggested or discussed have been snugly tucked in at the end of the "Bulletin" list. It is to these additional amendments we wish to advert to-day.

It appears that in addition to all the other amendments the Reserve Board wants to amend Section 11 by adding a clause "m." This amendment provides that: "Upon the affirmative vote of not less than five of its members the Federal Reserve Board shall have power, from time to time, by general ruling, covering all districts alike, to permit member banks" to do two things. The first of these things we will pass by as not pertinent to the present discussion. The second permits member banks "*to count as part of their lawful reserves Federal reserve notes of their own district*, not exceeding in the aggregate an amount equal to 5 per cent of their net demand deposits." Here we have the naked and undisguised proposition that Federal reserve notes, not gold, shall count as legal reserve. It must be admitted that this proposal is the necessary corollary of the steps the reserve banks have already taken in endeavoring to find a use for the notes which would keep them out indefinitely, rather than have them serve for trade purposes only, as distinctly provided in the law, but the principle is nevertheless a vicious one and utterly indefensible.

Of course the Reserve Board asks permission to endow the notes with the quality of reserve because it means to avail of the authority. There would otherwise be no sense in craving permission, since for emergency purposes the Board, under Section 11 of the law, has power "to suspend . . . any reserve requirement specified in this Act."

We cannot believe that the Reserve Board has sufficiently considered what would be involved in allowing reserve notes to take the place of gold, as reserve, otherwise it would not be lending its sanction to the scheme. The only proper reserve, the only true reserve, either for the member banks or for the Federal reserve banks, is gold. The fact that under our laws, as the result

of past errors, the legal tender notes of the government and silver certificates are allowed to count as reserve does not invalidate the force of the statement, but rather emphasizes it, and every careful student of affairs knows that the new Reserve Act was intended as a step in banking reform that would lead us out of and away from the old evils and practices, and not deeper enmesh us in the same.

During the debates in Congress the notion that reserve notes might with perfect propriety be made to fulfill the function of cash reserve kept cropping up again and again, but eventually conservative opinion triumphed, and now comes the Reserve Board and itself proposes that these notes shall, with its permission, constitute true reserve.

Standing all by itself the proposition would have to be condemned, but considering the peculiar relations existing between the reserve banks and the member banks, the proposition has a farcical element in it. All the capital of the reserve banks and also all of the deposits (except the relatively small amount which the U. S. Government keeps on deposit with the reserve banks) is contributed by the member banks. Certain reserve requirements are prescribed for the member banks, but it is not permitted that these reserves, in their entirety, shall remain in the control of the banks. The banks have no option but to transfer a portion of such reserves beyond their own control into the keeping of the reserve banks.

The gold thus obtained by the reserve banks furnishes the gold reserve behind the reserve notes which, with commercial paper as collateral, the reserve banks are permitted to issue. The reserve of gold required is, not 100 per cent, but 40 per cent. Accordingly, the gold obtained by the reserve banks furnishes the basis for note issues to the extent of two and one-half times the gold held.

Consider, therefore, what the proposition to count reserve notes as cash reserve would mean, as far as the member banks are concerned. As we have already seen, a certain portion of the reserves of the member banks *must* be kept with the reserve banks. That portion is, hence, wholly out of their hands. As for the remaining portion the Reserve Board proposes, under the amendment suggested, to give the member banks reserve notes based on the gold they themselves have contributed, but diluted to the

extent of 60 per cent, and let these notes constitute a good part of the reserve required to be held in vault by the member banks.

The way the proposition would work out, as far as the different classes of banks are concerned, is this: Under section 19 of the Reserve Law a member bank in a central reserve city must maintain a reserve equal to 18 per cent of the aggregate amount of its demand deposits; of this, 7 per cent must be kept with the Federal reserve bank of the district. Of the other 11 per cent it is now proposed that 5 per cent may consist of Federal reserve notes based on the first 7 per cent; this would leave only 6 per cent as the portion of real gold to be carried, but which in practice might consist of legal tender and silver certificates. In the case of the banks in the ordinary reserve cities, the reserve requirement is only 15 per cent, and the portion of this ultimately to be held with the Federal reserve bank is 6 per cent; with 5 per cent more held in the shape of reserve notes based on this first 6 per cent, there would be left only 4 per cent to consist of true reserve in the shape of actual gold, but which in practice, as in the other case, might consist of legal tender and silver certificates.

For the country banks the scheme would work worst of all. Here the total of reserve required is only 12 per cent, of which 5 per cent must eventually be kept with the Federal reserve banks; with 5 per cent more consisting of Federal reserve notes, there would be left only 2 per cent to consist of gold, legal tenders, or silver certificates. Thus viewed, in the cold light of facts, is not the proposition a most extraordinary one?

What can the object be in suggesting an amendment that would permit all this? We can think of none except that it would provide additional lodgment for these reserve notes which the Board is planning to issue in unlimited amounts and which it would keep permanently afloat. The framers of the law intended that the notes should have only a limited life. To carry out this idea and in order to guard against the notes staying out longer than absolutely necessary, the law expressly provides that no reserve bank may pay out the notes of any other reserve bank, under penalty of a tax of 10 per cent upon the face value of notes so paid out. In flat defiance of this intent of the lawmaker and the plain spirit of the law, the reserve banks have one and all been forcing the

notes into permanent circulation by withdrawing the commercial paper which originally served as a basis for the issue of the notes and depositing gold with the reserve agent for the nominal retirement of the notes, but which there is no intention of so using. The Reserve Board now comes to Congress and asks that the gold so held by the reserve agents shall be considered as gold belonging to the reserve banks themselves and allowed to count as part of the reserve which the reserve banks are required to hold against deposits and against reserve notes secured by commercial paper.

Not content with this they also ask authority to issue notes, not merely against paper rediscounted under the provisions of Section 13 of the Act (which is the only way the notes can now be issued), but *against paper purchased in the open market under Section 14 of the law.* Furthermore, they ask that the eligible classes of paper that may be purchased in the open market shall be enlarged and extended, so as to include bills of exchange and acceptances arising out of both domestic and foreign trade.

The Reserve Board seems to think that the beneficent character of the Reserve Act is to be measured by the volume of reserve notes that can be put afloat, and with these different amendments adopted a foundation would be furnished for an unlimited amount of the notes. And after every avenue had been glutted with the notes, it would no doubt be a great convenience if another large body of notes could be transferred to the vaults of the member banks and count as reserve.

But is the country prepared to take the risk involved in such a proceeding, or indeed prepared to have the notes go into unlimited and permanent circulation in face of the fact that we already have enormous paper issues in the shape of legal tender, national bank notes, and silver certificates! For ourselves we can only say that if the Reserve authorities are allowed to persist in their present course and their present intentions, the Reserve Act will prove, not an element of security and safety, as intended, but a menace and a peril.

APPENDIX TWENTY-THREE

QUOTATION FROM *THE CHRONICLE* OF SEPTEMBER 30, 1916, VOL. 103, P. 1153

The Financial Situation

Whatever else may be said of the speech which Paul M. Warburg delivered yesterday before the annual convention of the American Bankers' Association, it must at least be conceded that it has the merit of frankness. With this well written and carefully prepared address by a master mind available for perusal and study, no one need any longer be in doubt as to the plans and purposes of the Reserve Board. The consuming desire of the Board is to provide a basis for unlimited note issues, and with that idea in mind it would acquire all the gold in the country.

Mr. Warburg speaks of the "two billions of gold needlessly and wastefully scattered all over the country, unmobilized and inert" and says it must be mobilized and rendered effective. How? By getting it into reserve banks as a basis for note issues. He also speaks of the law continuing "the anomaly of requiring member banks to lock up in their vaults hundreds of millions of dollars, thus preventing them by legal enactment from giving additional strength to their own protective system, even if they should want to do so." In other words, he would have the banks keep all (instead of only a part) of their reserves with the reserve banks. Why? In order that the reserve banks may use the gold thus obtained as a basis for notes.

"I cannot urge you too strongly," he says, addressing the assembled bankers, "to coöperate to the utmost of your abilities in keeping your balances with the Federal reserve banks high, and your vault money down to the minimum that your own till requirements will safely and conveniently permit." This is the same thought. Let the banks keep only till money, and transfer all the rest to the keeping of the reserve institutions. The $700,000,000 to $750,000,000 of gold certificates and gold "at present

carried in the pockets of the people and in business tills" should be mobilized, thus "bringing under control gold reserves now scattered and more or less impotent." *Impotent* for what? Why, as a basis for the issue of reserve notes.

The exchange of a $10 Federal reserve note for a $10 gold certificate, he urges, would strengthen the gold reserve position. "We have now under control only about $500,000,000 of gold," declares Mr. Warburg, "while the country at large and the banks own about $2,000,000,000." Again, he says, the $600,000,000 of gold which has come into the United States since the Federal reserve banks opened should have gone into these banks. Why? So that Federal reserve notes could be issued against it. "Instead of strengthening the nation's centralized gold reserve, this gold has been allowed, because the Federal reserve banks' hands were tied, to drift into member banks or go into circulation." Is the gold, then, lost because it is in possession of the member banks? Is it not really safer there than it would be with the reserve banks if the latter are going to use it merely as a vehicle for new note issues on the basis of 40 per cent gold reserves? Certainly these member banks cannot issue notes against the same and thereby produce further inflation. Lest it be deemed we are exaggerating in suggesting such a possibility, we will say that Mr. Warburg urges without reservation that "instead of having had to pay out gold for $164,000,000 *of investments*, the Federal reserve banks should have had the power to *pay in Federal reserve* notes secured by 40 per cent gold, *thus retaining the balance of about $100,000,000 gold as a potential reserve for additional note issues if needed.*"

Finally, Mr. Warburg would have these same reserve notes, which are to be issued without limit, made reserve for member banks. He speaks of the law having "created the anomalous situation that while a balance with a Federal reserve bank could be considered as reserve, the Federal reserve note could not be so counted despite the fact that it is a prior lien against the assets of the bank, *and is the obligation of the United States*, while the balance *is not*." Here we have the old greenback notion that the government fiat invests a circulating medium with distinctive merit or charm. It is only another step to the declaration that a government fiat is all-sufficient and that no gold reserve whatever

is needful—the position assumed by the greenbackers. Mr. Warburg animadverts at every point of his argument against treating "Federal reserve notes as an asset that cannot be counted as a banking reserve." In other words, Mr. Warburg stands squarely committed to the doctrine that an "obligation," a debt, can count as reserve, when there is not a sound economic student anywhere who could contend that anything but gold can constitute true reserve.

We have from the first pinned our faith to Mr. Warburg, as the one man upon the Reserve Board who could always be depended upon to hold fast to sound teachings, and we have admired the spirit of self-sacrifice that induced him to give up business connections yielding lucrative profits in order to accept a position on the Reserve Board paying a few paltry thousands a year. Now, we find him straying from the fold like the veriest neophyte.

The argument that all the gold in the country—two billions of it—should be mobilized in the reserve banks, so that the latter can issue notes upon it, and that the gold is wasted unless it is used as a basis of note issues, proceeds upon the theory that more currency is needed in this country when, as a matter of fact, we now have an excess of it. We have in this country $346,681,016 of legal tenders, $734,493,851 of national bank notes, besides $568,270,900 of silver dollars and silver certificates and $188,015,961 of subsidiary silver. And yet the Reserve Board would like to see $2,000,000,000 of gold in the reserve banks, which would furnish the basis for about $5,000,000,000 of reserve notes.

It is surely a defect of the Reserve Act that it aims simply at inflation and does not provide any means of contraction. Under a properly adjusted system, with paper money redundant, the receipt of $500,000,000 of gold from abroad would have forced the retirement of a corresponding amount of this paper money. To the Reserve Board this $500,000,000 of foreign gold furnishes merely a pleasing vision of a new metal base on which to pile an additional pyramid of reserve notes.

It is matter for regret that the Reserve Board is not impressed with the need for contraction in our paper money issues at a time when foreign gold is pouring in here in such boundless measure. To be sure, at one point of his address Mr. Warburg does refer to

the advisability of retiring national bank notes, but not through their complete extinction, but by substituting reserve notes for them.

We cannot get ourselves to believe that the reserve banks should accumulate $2,000,000,000 of gold and we think that as a basis for note issues it would be exceedingly dangerous to let them possess so much. We think they ought to have an adequate supply for emergency purposes, and at other times ought to issue notes only sparingly. They now hold a large supply, probably sufficient for all needs, and it should not be forgotten that as the member banks grow—as their deposit liabilities increase—so also will the reserve banks grow.

We are of opinion that these member banks and the state banks and trust companies ought to hold large supplies of the metal in their own vaults and that considerable amounts of gold should likewise be in the pockets of the people and in general circulation, to be available in war times and on occasions of other emergencies. Mobilization should not go so far as to strip the members and the country bare of gold. For a nation to be truly on a gold basis, the gold ought to be in touch with commerce at every point. There are 27,000 banks and banking institutions in this country, and it would be a sorry situation if these had no gold of their own, but relied solely, or even chiefly, upon the twelve reserve institutions.

It seems to us, too, it would be sincere occasion for regret if the 500 or 600 million dollars of gold imported should have found its way into the reserve banks. The gold is in itself inflation enough. In the reserve banks it would afford the basis for reserve notes to 2½ times its volume.

Nor can we understand why the Reserve Board should be consumed with fears about the possibility of our having to give up some of the imported gold. There is no reason in the world why we should not be prepared to surrender a considerable part of it, or why there should be the least difficulty about doing so. Mr. Warburg says: "When we realize that the nation's gold holding in one year has increased about $500,000,000, it is well for us to consider whether or not we shall be able to hold this gold at the end of the War." We ought not to want to hold it all. We have no

need for it. It came to us under stress, and it would be selfish for us to attempt to treat it as being our exclusive possession.

We cannot see, either, why the Reserve Board should concern itself so much about possible gold exports. There is no reason why the burden of supplying the gold should fall upon the reserve banks, or why they should be so desirous of assuming responsibility in connection with it. There were gold exports of tremendous magnitude before the Federal reserve banks came into existence and the financial institutions at this and other centers have always known how to take care of the movement and will know how to deal with it in the future. The Reserve Board may rest easy on that score.

Finally, independent of the matter of gold reserves, it would be dangerous in the extreme to allow any body of men to issue these reserve notes by the thousand millions without limit or restriction. It was one of the strong points of the Reserve Act that the framers of the law hedged the issue of notes about with so many restrictions and safeguards. Some of these restrictions have been evaded or disregarded in the administration of the law. Others have been removed or weakened through the amendments to the law made at the recent session of Congress.

Mr. Warburg says the theory that notes may not be issued by the Federal reserve banks against gold without a certain reserve of commercial paper "makes all Europe laugh at us." But perhaps Europe does not understand our problems as well as we do ourselves. Mr. Warburg is trying to graft European ideas on an American political and banking system, to which these ideas are entirely unsuited. In Germany gold is so scarce that any gold outside the Reichsbank would be truly wasted. In this country we have not yet been reduced to any such desperate extremity.

APPENDIX TWENTY-FOUR

LETTER TO A BOARD MEMBER

Washington, D. C.,
November 10th, 1916

You were good enough to send me on October 23rd a copy of your speech and an appendix containing some thoughts of yours which you did not think it opportune publicly to express at this time but which you submitted to the Board members for the purpose of bringing about a general crystallization of views concerning this most important topic of note issue and reserves.

In going to the great trouble of reducing to writing our thoughts upon this subject, even though we disagree—or possibly because we disagree on certain points—you and I are rendering a valuable service for, as you correctly say, the time has come when, after an existence of more than two years, the Board has to take a definite position upon problems which are of so vital a nature and concerning which our banks are now entitled to definite guidance and instruction, one way or the other.

It is for this reason, and not for the pleasure of a controversy, that I think it my duty to analyze your speech and point out, with brutal frankness, where you and I are not in accord. The members of the Board, I believe, want to have both sides of the case presented as fully as possible before finally making up their minds.

Before taking up your argument, let me compliment you upon the admirable way in which you have presented it. While I differ from you as to some of your conclusions, I certainly could find no fault as to the form. You made a splendid presentation and you will have to bear with me if I do not attempt to equal your paper as to polish and style. But time is pressing and I shall confine myself simply to enumerating and discussing the various objections as they occur to me.

You are in accord with me as to the main objective of my recent address—that it is our duty to prepare our banking system so as to enable us to withstand large withdrawals of gold.

Let me say right here that I do not consider myself qualified to act as a prophet. I do not know whether at the end of the War gold will be withdrawn at all. Nobody can say that to-day, because it will depend upon the question whether or not the credit of the now belligerent countries at that time will still be strong enough to draw gold; and that, again, will depend upon the further duration of the War. On the other hand, it may be that we shall have to lose a great deal of gold. My contention is, not that we shall or shall not lose gold, but that it is the duty of a Federal Reserve System to forearm in a manner that will enable us to lose gold without creating unnecessary convulsions. That we can protect ourselves and stop gold withdrawals in case they should work havoc with us, I have no doubt. But what I wish to avoid is that we should be forced to do so unnecessarily early, because it would mean that, to our own detriment, we should have to force up our own money rates and that we should have to stop granting credit facilities to other countries. I believe, however, that having grabbed so large a share of the world's gold and wealth we should consider it our moral duty to stand prepared to open our doors wide and contribute a phenomenal share in the work of reconstruction and construction that will have to be done after the end of the War.

I have, therefore, little sympathy with your argument that if we prepare to lose about $600,000,000 of gold we have done our duty. If we should have to lose these $600,000,000—the arbitrary amount which you take as the basis of your argument because it happens to be the net accretion of gold at this time, though in a few months it may amount to much more—our gold reserve on the basis of your calculation would have shrunk to 35 or 40 per cent, respectively. You and I are in complete accord that this reserve is the minimum; but a minimum which should not be reached and which could not be considered satisfactory or a safe basis for our banking structure. If we reached that point we should certainly have to stop granting any further facilities outside of the United States, contract credits at home, and try by all possible means to reëstablish a higher and safer basis of note and deposit gold cover.

My contention has been that we should be prepared to lose $500,-

000,000 or $600,000,000 of gold and still have $200,000,000 or $300,000,000 "free gold" in reserve, so as to keep intact our own credit machinery in case gold exports should occur in these large proportions.

Your point of view is that it is safe enough to begin to hustle to secure these missing two or three hundred million dollars of gold when the emergency arises.

My experience as a banker makes me distinctly disinclined to rely upon that course. I believe that Governor Strong in his letter to you has admirably shown how little reliance in this connection we could place upon voluntary coöperation of our thirty thousand banks. When our reserves are down to 35 per cent they will not be so eager to give us their gold in exchange for Federal reserve notes, particularly in times when gold is the one thing that other countries will draw from us and that we, at such time, will not be eager to part with.

And again, if you have in mind a situation such as that at the beginning of this war, you will observe that critical times—particularly during complications that spring up suddenly—bring about increased demand for currency. During those times the banks pay out a lot, but the volume of currency that is paid into the banks and for which alone gold circulation at that time could be substituted, is very unimportant, if at all existent. You have, of course, in mind the illustration of the issue of $470,000,000 *additional* currency in 1914. If during a critical period a determined appeal should be made to the public to turn in its gold, it might lead to increased alarm and panic, unless we were involved in a situation similar to that governing France and Germany where they were dealing with a national emergency and plainly appealing to the patriotism of all citizens.

But, frankly, I cannot quite understand why you should have taken exception at all to my point of view. When you figure out why we are strong enough to meet emergencies you rely on three items: One, our actual gold reserve taken from the member banks' deposits; two, the amount now impounded with the Federal reserve agents; and, three, the increased balances to be kept with Federal reserve banks produced by transferring member-bank vault money to the Federal reserve banks.

As to the process under No. 2, in trying to prove that we are strong enough at this time, you base your argument upon $120,000,000 of free gold which the reserve banks may rely upon, owing to the fact that they have impounded more than $200,000,000 of gold with Federal reserve agents. You recognize this method as necessary and advisable in its present scope. You do not object to its being continued; for, as a matter of fact, it has got to be, provided the present indirect methods are applied. You also approve that this method of exchanging Federal reserve circulation for gold circulation be fully legitimized and pushed as far as it can be in case your $600,000,000 should prove an insufficient reserve; as a matter of fact, you have sanctioned the process in the past, you sanction it in the present, and you rely upon it for the future. And I am frank to say that I do not quite see why you should consider my plan as a process of "artificial shifts and manipulations . . . distorting and disfiguring our banking system to its own prejudice and to the prejudice of the country's real interests." As a matter of fact, you approve of the principle and disagree only as to the question of degree, taking it upon yourself to say that a definite amount is sufficient at this time, while in other parts of your speech you say yourself that "it will be prudent, in making our calculations, to take note of the possibilities as well as the probabilities, particularly as the latter are so incalculable." However, I would be quite willing to leave your contentions unchallenged and allow nature to take its course if I were not so fully convinced that your process under No. 3 would be practically nullified by your disinclination to legitimize fully and modernize the issue and use of Federal reserve notes. Practical experience will show you very promptly that, no matter how hard we may try to have our member banks increase their balances with Federal reserve banks by transferring a substantial share of their vault money, this will not be accomplished until they may count a reasonable amount of Federal reserve notes as reserve. Our present deposit structure of member banks is too gigantic to make them willing to operate with a supply of till money which would merely respond to their average till requirements. Every conservative bank must be in a position to pay out promptly, without the least bit of hesitation, a very substantial portion of its de-

posits. They will, therefore, wish to have at their immediate command, without any possible delay, a substantial amount of currency. No doubt they would be willing to rely upon Federal reserve notes for satisfying their depositors and would be quite willing to keep in their vaults, let us say, an amount equal to about 3 per cent of their deposits. But they cannot afford to do this, because their sending of the corresponding 3 per cent of their gold to the Federal reserve bank as additional balance would mean that they would carry, not 3 per cent, but 6 per cent in order to provide this amount of available currency in Federal reserve notes. That is something the banks will never do. It is a loss which would appear to them entirely unnecessary and unwarranted, and would simply mean that that amount of gold will be kept in their vaults.

You will answer that this may be correct as far as the banks are concerned which are not located in Federal reserve cities, that banks which are in Federal reserve cities could afford to rely upon their ability to send across the street to their Federal reserve bank and get currency, and that, therefore, these member banks could reduce their cash holdings to the amount which is actually required for daily till uses. That would be correct, but it will not work out that way in practice. As a matter of fact, experience shows that the strong banks in London, Paris, and Berlin keep a large amount of till money in order to be prepared immediately to meet all emergencies without being forced to send outside of their building, and it also must be borne in mind that these very strong institutions have a sort of pride in not applying too frequently to the central banks. Normally, they like to keep their investments and collections so well balanced that additional cash requirements can be taken care of by collecting a larger proportion of their daily maturities. In our case, it would mean that while the strong member banks may keep large excess balances they will keep part of this excess in their own vaults. Or, if their excess balance with the Federal reserve bank is being drawn down or withdrawn, their excess vault money acts as a supplement to their Federal reserve bank balance. If in that case they had Federal reserve notes in reserve it would be necessary for them to send them over to the Federal reserve bank and convert them into a

balance because otherwise these notes would be useless as reserve and, under the circumstances, it stands to reason that they will rather hold on to a comfortable amount of gold or gold certificates. But there is another reason for their doing so, and that is that as long as the law makes this differentiation between government obligations, calling the gold certificate, the silver certificate, and the greenback first-class money and the Federal reserve note second-class money, the member banks will feel a greater degree of safety in commanding the first-class money than the second-class. The sifting process will, therefore, continue and the large banks will have some kind of a subconscious feeling that as long as the Federal reserve banks are paying in currency which is second class and not worth to the member banks as much as what they would consider real first-class money, the Federal reserve bank balance too is not quite so good as their gold. Moreover, these strong banks, on which a great many correspondent banks still rely, and which are by law obligated to keep the higher reserve of 18 per cent for the very reason that, to a large extent, they are the correspondents of banks, would have a feeling of apprehension lest *their* gold placed in the Federal reserve banks would be used for the protection or credit expansion of the entire country, so that their actual gold reserve would be watered while the thousands of country banks would hold on to their gold. In other words, it would be a one-sided proposition which would not appeal to the banks in the Federal reserve cities and would militate against the carrying out of your plan. This is a most important feature which you must not overlook. It will prove to make your entire program illusory.

But, even if your program could be carried out on the very basis that you appear to have in mind, I would personally consider it a very unfortunate one. The policy of the entire Federal Reserve System in that case could be controlled by the strong banks in the central reserve cities. If at any time the Federal reserve banks became aggressive in a way that would annoy them they could at once collectively reduce the operating power of the Federal reserve banks by withdrawing their excess balances and putting them back into their own vaults.

My plan of securing an overwhelming amount of gold for the

Federal reserve banks by withdrawing it from circulation and making every citizen of the United States who carries a note in his pocket permanently a quasi-depositor of the Federal reserve bank, would free the Federal reserve banks from the exclusive control by their large member banks. Incidentally, as I have tried to show in my previous paper, it would immensely strengthen the power of our System and the confidence that it would command, not only at home, but also abroad.

You appear to think that the process proposed by me would lead to a "distortion of our gold standard." Nothing could be more unwarranted than such a thought. In my previous paper, I tried to show as plainly as I could that we must differentiate between reserves of member banks and reserves of central banks. Unfortunately, this point of view has been completely left out of consideration in your paper.

The gold standard is not affected at all by what I propose to do. Quite the contrary, my plan has for its very object to mass under our control the gold running wild in our country so that we may better protect our gold standard. If your plan could be carried out, there would remain in the vaults of the member banks only 2 per cent in till money and all the rest would go into the Federal reserve banks. This 2 per cent would amount to about $175,000,000. I fail to see why $175,000,000 of Federal reserve notes placed in the vaults of member banks and against which a minimum of $70,000,000 of gold must be held with Federal reserve banks, permitting a net possible inflation of $250,000,000, should frighten you so and justify you in trying to combat a development—which otherwise can only redound to the greatest benefit of the entire country and would, as a matter of fact, secure the independence and growth of the Federal Reserve System—if, on the other hand, you are quite willing to let the total reserve required, of about $1,275,000,000, be carried as balances with the Federal reserve banks upon which theoretically they could build an additional note issue of about two billions. But we need not be afraid of securing that much. We shall neither get all the gold held in member banks' vaults, nor more than a substantial percentage of the gold now in circulation; but, without the proper recognition of the Federal reserve note, we will not begin to secure a sufficient

supply of gold to provide for adequate strength and growth considering our possible necessities and probable opportunities.

You have in your mind a very distinct apprehension that through the amendment that we have often discussed the character of the Federal reserve note might be destroyed; that we might interfere with "the unique excellence of the note provisions of the Federal Reserve Act which provide a maximum of elasticity with a minimum of danger of over-issue." I give you below a condensed statement of all Federal reserve banks as of last Saturday; and underneath you will find the same condensed statement as it would look if our amendment had gone through.

FEDERAL RESERVE BANKS

(in millions of dollars)

(I)

Assets:		*Liabilities:*	
Gold	432	Capital	56
Paper	110	Govt. and member deposits	580
Other investments	108	Federal reserve notes	14
	650		650
Federal Reserve Agent:		Reserve against deposits and notes combined	72.7%
Gold	214		
Commercial paper	14		
	228		

(II)

Assets:		*Liabilities:*	
Gold	646	Capital	56
Paper	110	Deposits	580
Other investments	108	Notes	228
	864		864
		Reserve against deposits and notes combined	80.0

I wish you would show me how there would be any quicker redemption under (I) than there would be under (II). In effect they are absolutely alike. No matter how we keep our books,

there are in effect in both cases $228,000,000 Federal reserve notes outstanding, of which $214,000,000 are secured by gold and $14,000,000 by commercial paper. If this paper is collected at maturity, the entire $228,000,000 will be covered by gold. If any Federal reserve notes are actually presented for redemption, nobody could tell whether the originally gold-secured notes or the paper-secured notes are paid for. The individual outstanding notes to-day have no earmarked collateral of paper or gold. They are in effect secured by both; and all that our amendment proposed was to clarify a condition which, as a matter of fact, exists already to-day.

Elasticity is a question not of the individual notes but of the aggregate volume of outstanding notes and (the simple substitution of Federal reserve notes for gold circulation leaving the volume unchanged) this volume is controlled by the increase or decrease of the Federal reserve banks' investments. No matter whether or not a Federal reserve note is held in a member bank's vault as reserve or is circulating in the pockets of the people, it will be redeemed and converted into gold whenever the Federal reserve banks collect their investments. I cannot for the life of me see how the redemption of Federal reserve notes takes place faster in one case than in the other. It follows automatically the collection of the Federal reserve bank's investments.

You say:

> It is unthinkable that twelve banks should be in a position to issue notes which would be available as reserve money—in other words, that there might be twelve varieties of bank reserve money, similar in nothing but appearance and the fact that they bore the endorsement of the United States Government.

I had hoped very much that you could follow the reasoning contained in my Kansas City speech that, in dealing with member banks, we should stop talking of reserve money, which, indeed, is an "obsolete" manner not even found in England, which you have chosen as your model. Bank balances and vault money are carried there indiscriminately in one item. Whatever is good enough for the public to accept as current money is included in

the item "cash and bank balance" by English banks and, for that matter, by French, German, and other banks. When the Peel Act was suspended in England and notes were issued by the Bank of England against any kind of security, there was not a bank in England that would not include Bank of England notes in the item "cash and balance with the Bank of England." One note of the Bank of England was treated like any other note of that bank. There was no differentiation between those issued against gold and those issued against securities. As a matter of fact, there always has been a certain amount of government securities against Bank of England notes and that never has prevented the English banks from counting those notes as cash. To-day, when there are outstanding $650,000,000 of currency notes issued by the British government, with a gold cover of 21.6 per cent, these currency notes are included in "cash and balance with the Bank of England" together with Bank of England notes, even though these currency notes are secured by only so small an amount of gold cover and the remaining cover consists of government securities, while our Federal reserve notes are secured at present by about 100 per cent of gold. No matter what Hartley Withers may say about the desirability or probability of making the Bank of England note a pure gold note at the end of the War, I believe that nothing of the kind will happen and that, quite the contrary, as the probable development we may much rather expect at the end of this war that the Bank of England will be reformed to correspond more to the Continental systems with an elastic note issue. Sir Edward Holden's speech on this point is very instructive. As a matter of fact, he had worked out a plan for the English member banks to assemble additional gold reserves (for the very reason that the Bank of England, under its present organization, is not able to control a sufficient amount of gold) and, in time of emergency, to deposit this additional gold with the Bank of England and make it the basis of an elastic note issue on the Continental plan. Whenever this plan were carried out, the Bank of England notes would be part and parcel of the item "cash and balance with the Bank of England."

I fail to see any sound reasoning in Hartley Withers's contention. When the bulk of the British banks' "reserves" consist of balances

with the Bank of England, which are never fully secured by gold (at present they have a reserve of about 23 per cent), why should the Bank of England note not be included in "Cash and balance with the Bank of England" unless it were secured by 100 per cent gold—which it never was?

But, to return to your argument: If you object to twelve varieties of reserve money, how can you justify that the total reserve of a member bank may be kept as balance with one of the twelve Federal reserve banks—balances which in that case are not guaranteed by the United States? Are these not twelve different varieties of reserve money, less adequately protected reserve money at that than the obligation of the United States! Moreover, are you quite justified in saying that these notes are "similar in nothing but appearance and the fact that they bore the endorsement of the United States Government?" Is it not a fact that these notes are absolutely identical all over the country except that there has been printed upon them the seal of the respective Federal reserve bank to make them distinct as to the point of redemption? In the pockets of the people they are absolutely the same identical instrument. The only difference is that when they come back to other Federal reserve banks they may not pay them out. They are not *endorsed* by the United States. They are the *obligation* of the United States and, furthermore, they are alike in this, that there must be held against all of them at least 40 per cent of gold. As far as the member banks are concerned, all these notes are alike. They can present them for payment wherever they please and whenever they hold them they hold the sacred obligation of the United States to pay in gold.

Your paper proceeds on the theory that the Federal Reserve System has been fashioned upon the British system as against the Continental systems; that the British system is good and ought to be imitated by us; that the Continental systems are bad, or anyhow that they would be bad models for our Federal Reserve System.

I have to take issue with both of these points. The most characteristic difference between the Bank of England and other central banks is that the Continental banks have an elastic note-issuing power while the note-issuing power of the Bank of England is rigid. The very object of the Federal Reserve Act was to provide

for an elastic note issue and this note issue was copied from the Continental banks. We had a rigid note issue before the enactment of the Federal Reserve Act and were subject to all its fatal consequences. Are you not blowing hot and cold? On the one hand, you consider the Federal Reserve System, with its elastic note issue, a great advance made by the United States, and correctly so. On the other hand, when conclusions are to be drawn, and when we ought to benefit from the experiences of the very countries which developed this method of the elastic note issue, you cling to the principles and the experiences—and bad experiences at that—of the rigid note-issue country and, in doing that, you can only create an unfortunate confusion.

I do not want to go too closely into your paper, but it appears to me that the parallel between England and the United States is poorly chosen for the additional reason that, while you say the bank note has become obsolete in England, you cannot possibly say the bank note has become obsolete in the United States, where there is a per capita amount of $42 of money. It is not a question of whether or not the bank note becomes obsolete, but it is the question, whether or not the use of money becomes obsolete. If I understand you correctly, what you mean is that in England so much is being paid by check that the actual use of money has become an unimportant feature, and the check has taken its place. But that certainly cannot be said of us. No doubt the check plays a large part but, in spite of that, we have a large volume of money in circulation and a large fluctuation in the volume of money caused by such processes as crop movements which do not affect England. Moreover, I think you underestimate, on the other hand, the amount to which clearings and giro are used on the Continent, tending to reduce the use of actual money. You will find attached a statement of the amounts of obligations that have been settled in Germany either by the giro system, or by clearings, or by post-office transfers and post-office checks. Moreover, as you know, there is a movement afoot in Germany to encourage the use of checks, a process which has been started on several occasions but which unfortunately, by reason of a petty fiscal policy of putting a stamp tax on checks, was killed upon each occasion. I mention this only for the purpose of adding that even after the check system is

established in France and Germany, you will find that there will not be any difference in their method of handling notes. The notes of the Banque de France and of the Reichsbank will continue to be counted as cash together with the balance with the central banks.

I should be very much mistaken if, after the War, there would not be a strong development in all now belligerent countries to use the check and the bank note as the means of payment of internal debts. The check and the bank note will both act as "yard sticks" and as media of clearing; the gold will be concentrated in the central banks in order to be available for the settlement of international debts.

I think you are moving between two extremes. On the one hand, you are a passionate advocate of the highest development of the use of checks. You have sometimes gone so far as to call the check a "means of currency." On the other hand, however, you appear to me to be an advocate, not of the bank note, but of the gold certificate or actual gold circulation. While I am in full accord with you as to the desirability of the development of the check system, I am distinctly opposed to the wasteful method of using the gold itself as a means of exchange; that is to say, actual barter in each case, actual value, instead of using the "yard stick," the check or the bank note which are obligations to pay in actual money.

I know that you and I are in accord that at this time, when we have grown so tremendously rich and strong through the misfortunes of others, it would be nothing less than a crime to build around the United States a high tariff wall so that we may hold all we have taken and prevent any part of it from going back to Europe by having goods sent here that, in spite of her handicap, Europe will be able to produce cheaper than we. And I think you and I, furthermore, are in accord that the same point of view ought to be taken when we are dealing with the question of our gold position and banking power. Simply because we should have neglected to organize our wealth and because we insist upon squandering our gold all over the country, we should not be in a position of being niggardly or provincial when the time will come for us to do our full share in the reconstruction and further construction of the world. We should not entertain the eventuality of raising our

discount rates so high that our own securities should go back to Europe, as you appear to contemplate, or so as to kill the new acceptance business with which we have begun to finance the world and, incidentally, of throwing a damper on our whole home situation by a policy of rigid contraction.

Again let me say that I do not want to prophesy. Ultimately such conditions may arise, but they should not occur any earlier than necessary because of our neglect to take the most elementary precautions in assembling our gold.

Even though some of the foreign loans maturing in the next years will not prove to be weapons of defense, because they are secured by our own collateral . . . we are no doubt strong enough to be able to protect ourselves. But, as I said, I do not believe we want to be protectionists to a degree which would be harmful to ourselves and to the entire world because we neglected to prepare.

I believe that you will say that you are in full accord with me with respect to these objects and aims and that we differ only slightly as to the methods, and that, after all, your main objection is based upon your fear of the over-issue of notes. But, as I showed you before, this over-issue on a basis of 2 or 3 per cent of till money could only be a very restricted one. Moreover, this objection could be met by limiting to a definite percentage the amount of till money kept in Federal reserve notes. Personally, I should be satisfied to have this percentage fixed at 2½ or 3 per cent as against the 5 per cent contained in our last recommendation to Congress. At the same time, I should favor beginning the tax on the notes whenever the gold cover fell below 70 per cent. These would be two very important brakes upon any tendency to over-issue on account of an excessive amount of Federal reserve notes kept in vault but, in addition to that, you must trust the sound judgment of the Federal reserve banks to keep the System safe and sound. If you have not that confidence, you could not possibly undertake to urge the member banks to place their excess balances with the Federal reserve banks. As a matter of fact, there is at this time, after two years of operation, a very clear understanding on the part of the Federal reserve banks that their normal reserves ought to be between 60 and 80 per cent, and our System is being run on that basis.

You cite some foolish suggestions that were made by bankers from time to time as an illustration of the dangers to which the System would be exposed. I think the argument ought to be reversed. The fact that these foolish suggestions were turned down with contempt and ridicule is the best proof that, on the whole, the common sense of the banking community can be trusted. The danger remains, of course, that they may want to go far in business expansion, but there you have to rely upon the ability, intelligence, and conscience of the Federal Reserve Board and the Federal reserve banks. If these are lacking, the country will have to pay the price whether or not the Federal reserve notes are counted as reserve. But I, for one, believe that the further we get along the better understood will be sound banking principles and the easier will it become to secure for the banks and for the Board men capable of handling the situation. The constant publicity to which the System is subjected is, in itself, an important safeguard.

You cite present European conditions as indicating the possibility of inflation under a central banking system. I should cite them to you as proofs of the most effective instruments of protecting a country under tremendous stress. As a matter of fact, the danger in these countries is not so much from currency expansion as from the tremendous growth of their national indebtedness. But that an elastic note issue under conditions such as govern Europe at this time is an absolute necessity will not be denied by you, and it is proven by the fact that even England had to take recourse to this means by issuing an unsecured government note circulation.

In conclusion, let me state frankly to you that I think you are "seeing ghosts" when you believe that Federal reserve notes as reserve would prove to be the undoing of the regional system. Quite the contrary, it would be the making of it. It would strengthen the banks and make them independent.

You say:

> It would be the first step toward the process of substituting the principle of centralism in our banking system for the principle of regionalism.

The principle of centralism has been introduced by the creation

of the Federal Reserve Board through its power to make one bank rediscount for the other; through its power to regulate interest rates all over the country and, furthermore, through the very creation of one Federal reserve note issue which circulates all over the country without any differentiation. These Federal reserve notes are the obligations of the United States, and the Act prescribes:

> The said notes shall be obligations of the United States and shall be receivable by all national and member banks and Federal reserve banks and for all taxes, customs and other public dues.

Is it at all plausible to contend that this Federal reserve note is a regional note when the law obligates all member banks all over the country to accept it? I think it is belittling the Federal Reserve System if you should consider that a step of this kind would be a "perversion of its most fundamental principle."

You furthermore say:

> As such, I cannot but view it with the most serious apprehension. The regional principle is the vital principle in our new banking system. It is America's specific contribution to the business of reserve banking. A banking system is a growth and development, and the regional principle, which is the life-giving force of the Federal Reserve System, grew out of the clearly perceived necessity of adapting the structure of any system of reserve banking which would fit American conditions to the analogies of our political and economic life and the genius of our people.

The regional feature of our System is a necessity; not a beauty. The time may come when, after generations, our country may enjoy a central banking system as safely as do European countries at this time. In view of our political conditions and our peculiar economic conditions, a system was thought preferable that would insure a certain degree of decentralization. It is in response to this necessity that the regional system was adopted, but the creation of a system of distinct Federal reserve districts and Federal reserve banks would have been an absolute failure had they not been welded together in one strong unit by the coöperation

secured through the Federal Reserve Board and by placing behind the whole System—in order to eliminate the weakness caused by the creation of comparatively unimportant Federal reserve banks —the great power of the United States. This led to the issue of Federal reserve notes by the government instead of a bank note issue as in Europe. It was done for the very reason of uniting the banks and not for the purpose of separating them. The objects and aims of those who want to further the development of this principle of regionalism must be to overcome the difficulties that are caused by the many-headedness of the System; to overcome the weakness, as far as it can possibly be done, and to create the greatest possible confidence by dealing with the System as a whole instead of dealing with twelve distinct institutions, including some pretty weak brothers. It is from this point of view of immeasurable advantage to use this common note issue, which is backed by the strength of the United States, as a joint instrument to strengthen the whole System and to give it a power that no individual reserve bank could possibly enjoy.

The measures proposed for the strengthening of the gold and credit power of the Federal reserve banks are the most important steps that could be taken in that direction. They would make for the independence of the districts, and they would tend to give to the United States as a whole that great banking power that would enable us in safety to cope with the problems that lie ahead of us.

P. M. W.

APPENDIX TWENTY-FIVE

PRESS STATEMENT ISSUED BY THE FEDERAL RESERVE BOARD ON JANUARY 13, 1917

After having given much attention to the problem of controlling and regulating the gold supply of the United States and to the question of bank reserves in general, the Federal Reserve Board has prepared and transmitted to the Chairmen of the Committees on Banking and Currency of the Senate and House of Representatives recommendations for the amendment of the Federal Reserve Act. While it is not deemed desirable to give out the text of the amendments transmitted, since they will probably soon be introduced in Congress, the following general statement concerning them is made public.

When the Federal Reserve Act was drafted its principal object was to deal with national problems of banking and currency. Since its enactment financial and economic conditions in the United States have undergone far-reaching changes which were not foreseen three years ago. The United States has grown to be a world power in financial affairs and it seems necessary that the Act, which has proved of such great value in the treatment of our domestic problems, should now be amended in order to enable us to deal effectively with the new international problems which seem destined to play so important a part in our economic life. The banking system of the United States should be prepared to meet effectively two conditions of opposite character—one, the excessive and uncontrolled inflow of gold, the other the excessive and unregulated outflow of gold. The amendments proposed are designed to provide means of controlling an over-extension of loans based on new accretions to our gold stock and to provide for the mobilization and concentration of the gold holdings of the United States so that the flow of gold back into Europe, or to South America, or to the Orient, may be arranged without forcing any violent contraction of loans or causing undue disturbance to legitimate business.

Of approximately two and three-quarter billions of gold in this country there are held or controlled by Federal reserve banks about $736,000,000, of which Federal reserve agents hold $283,000,000 as security for Federal reserve notes outstanding, and $453,000,000 is reserve money and must therefore be used conservatively. But even assuming that the Federal reserve banks were willing to reduce their gold reserves to 40 per cent of their deposits and note liability (which would be regarded as a minimum and in normal times would be inadequate) the amount of free gold, i.e., the amount of gold that the Federal reserve banks would lose before reaching this 40 per cent minimum, would be a little more than $375,000,000. While this is a very large sum its sufficiency cannot safely be assumed when we consider the wide scope of our transactions in world finance and the phenomenal growth of our own credit structure.

It is estimated that there are now in the hands of the public, i.e., outside the Treasury and the banks, over eight hundred million dollars in gold and gold certificates, and that there are at present held in the vaults of member banks about $815,000,000 of reserve money of which $540,000,000 is gold coin or gold certificates. There should be added to this estimate about $600,000,000 of lawful money in the vaults of non-member state banks and trust companies.

Note Amendment

The Federal reserve note, which is an obligation of the United States secured by an ample reserve of gold and commercial paper, is accepted as willingly by the public as a national bank note or as any other form of currency, and the public does not discriminate between different forms of United States currency. Federal reserve note circulation has been substituted for gold certificates to the extent of about three hundred million dollars.

Under the present law this gold is deposited with the Federal reserve agents in redemption of the Federal reserve notes issued against it. The note so provided for thereby in effect ceases to be an obligation of the Federal reserve bank; but as the gold does not figure as an asset of the Federal reserve banks, the Federal reserve banks are unable to show the greater strength which might be evidenced if the law permitted, as proposed in the amendments,

the issuance of Federal reserve notes not only against commercial paper, but also against gold or against either, provided always that every Federal reserve note must be covered by at least 100 per cent of commercial paper or gold, and that there must always be a gold reserve of not less than 40 per cent against all outstanding Federal reserve notes.

Reserves

The control of gold by Federal reserve banks in times of abundance such as at present, will decrease the danger of inflation of domestic credits and at the same time will enable the country when the tide turns to part with large sums of gold with less inconvenience or shock, thus enabling us more safely and effectively to proceed with the development of our foreign trade and to give the necessary credit facilities for its extension. The United States should be in a position to face conditions which may call for an outflow of gold without any disturbances of our own or to the world's business, and without making necessary drastic changes in our interest or discount rates. The amendments suggested by the Board are designed to enable the Federal reserve banks to withdraw gold from actual circulation while enabling member banks at the same time to release gold which at present is tied up in their own vaults. The amendments are based upon the theory that all of the individual banks should strengthen the gold holdings of the Federal reserve banks. The country's holdings of gold are not used most effectively when they are in the vaults of a large number of banks scattered all over the country, but its greatest use would come from concentrating it to a greater degree in the vaults of the Federal reserve banks, where it can be effectively protected when not required and effectively used when needed. The member bank does not require gold with which to supply the ordinary demands of its depositors so much as currency.

It is from this point of view that the Federal Reserve Board has proposed that Congress increase the required reserves to be maintained by member banks with the Federal reserve banks. On November 17th, 1916, the cash holdings of all member banks were about $815,000,000. Under the proposed amendment of Section 19, $250,000,000 of this amount would be transferred to the Federal reserve banks. Hence the Board believes that ultimately the law

should require of member banks no more than that they should maintain specified balances with the Federal reserve banks in amounts adequate to supply the necessary reserve basis, and that the Federal reserve banks must have sufficient reserves of gold with which to protect all obligations, but that there should be no legal requirement as to the amount of currency that a member bank should carry in its own vault. This is a matter of business judgment that might well be left to the discretion of each member bank. It was thought, however, that if this principle were carried into full effect at this time, the step might be considered too extreme, particularly under present conditions, and nothing should be done that might tend to a further release of reserve money.

A minimum amount of currency that the member banks should be required to keep in their vaults is, therefore, prescribed. The amount suggested is 5 per cent of the demand deposits, so that the total requirements—cash and reserve—will remain practically unchanged. While the effect of some of the proposed changes will be to reduce somewhat the reserve requirements, the reserves will be increased by the abrogation of the practice hitherto observed of counting items in transit or "float" as reserve. The permission given member banks to use their own discretion as to the character of currency in their vaults, will enable them to release the gold they now hold, with the important result that the substitution of Federal reserve notes for gold and gold certificates will be facilitated by this change in the law. Without some such change member banks will continue to ask for gold certificates in small denominations, because as long as they must have gold or lawful money to count as reserve it would be impossible for the banks to exchange them for Federal reserve notes.

Other Proposed Amendments

Besides the proposed changes relating to note issues and to reserves the Board has suggested also the following:

Amendment of Section 11 so as to permit the Federal Reserve Board to raise reserve requirements in emergencies, just as it is now empowered in certain contingencies of a different kind to lower those requirements.

This provision would, if adopted, enable the Federal Reserve

Board in prolonged periods of extreme ease in the money market to check any tendency toward excessive loans or other forms of undue extensions of credit.

Amendment of Section 16 to permit non-member state banks and trust companies, even though too small to be eligible for membership in the Federal reserve banks, to avail themselves of the clearing and collection facilities of the Federal reserve banks, provided that they cover at par checks on themselves sent for collection by the Federal reserve bank, and provided further that they keep a compensating balance with the Federal reserve bank in an amount to be determined under rules prescribed by the Federal Reserve Board. This is not intended to operate as an extension of any of the privileges of the Federal Reserve System to non-member banks at the expense of members, but on the contrary the amendment is proposed primarily for the convenience of the public and incidentally for the benefit of the member banks. It is contemplated that the compensating balances which non-member banks participating in the clearing plan will be required to keep with Federal reserve banks, will be sufficiently large to protect member banks and justify Federal reserve banks in undertaking the service. Any clearing and collection plan to be effective must be so comprehensive as to include all checks. At present the par lists of the Federal reserve banks include the names of banks checks on which can be collected in any circumstances at a minimum of time and expense, but do not embrace a large number of towns in every State where there are no member banks; and in order to make collections on such points many banks are obliged to maintain accounts in addition to their reserve accounts with the Federal reserve banks. A necessary factor in any successful clearing plan is the offset, whereby balances only require settlement instead of the total volume of transactions. As long as the clearing system does not embrace all of the banks this offset is lost in a corresponding degree and the value of the System diminished in proportion.

Amendment of Section 25 to authorize member banks located in cities of more than 100,000 population and which have a capital and surplus of more than $1,000,000 to establish branches in the

same city, provided the State laws do not prohibit state banks and trust companies from establishing branches.

Amendment of Section 9 to authorize mutual savings banks not having capital stock to become associate members of the Federal Reserve System under certain prescribed conditions. The principal beneficiaries of this amendment would be the mutual savings banks of the eastern and New England States, which cannot become members of the Federal Reserve System under the present law owing to the lack of any provision enabling them to subscribe for capital stock of a Federal reserve bank, as they have no capitalization of their own upon which a percentage could be based. They would be required to carry a reserve balance with the Federal reserve bank against their time deposits in the same proportion as member banks; and the accommodations proposed for mutual savings banks are limited strictly to the discount of their thirty-day obligations properly secured.

APPENDIX TWENTY-SIX

LETTER TO A FRIEND CONCERNING FIAT MONEY

November 3rd, 1913

DEAR FRIEND:

I have received your letter this morning, and I consider it almost a joke to receive a letter from you, emphasizing your position of loyalty to your government and its institutions, and upbraiding me as favoring the issue of "fiat" money. It would lead too far to enter upon a controversy in writing upon this subject, but all I want to say is this: I do not believe that any one in this country has given more time, thought, and energy to this fight for sound money than I have, and as you may have noticed from my pamphlet, I am as heartily opposed as you are to the issuance of elastic currency by the government. There is a great difference, however, between a guarantee and a direct issue. Nobody would call the notes of the German Reichsbank "fiat" money, if the German government would decide tomorrow, that it wanted to guarantee those notes. I agree with you, and I think I made that clear enough in my pamphlet, that all direct connection between the government and the banking business is undesirable, but you must not go to extremes and call "fiat" money what is not "fiat" money. By overdoing the matter, we simply weaken our position. I have always believed that in order to secure legislation in the United States, we would have to concede a guarantee by the government of the notes, and I even expressed this in my pamphlet, which was published, I believe, in 1910 or 1911, before the Aldrich Plan was published, and before the Owen-Glass discussion began, so I have not given way, as you appear to think, but, in this respect, I simply stand where I stood long before the question became acute.

Before I sailed for Europe, we sometimes had the good habit of lunching together. How would it be if we solved the question of "fluidity" and very "liquid" assets by taking a cocktail together, this or next week?

P. M. W.

APPENDIX TWENTY-SEVEN

QUOTATIONS FROM AN ADDRESS ENTITLED "BANKING REFORM IN THE UNITED STATES," DELIVERED BY NELSON W. ALDRICH[1]

Criticism of the Bill

In considering the character of the remedies proposed by the bill which recently passed the House of Representatives I am not unmindful of the fact that it is much easier to criticize than to construct, and I certainly do not intend by any criticism I may make to increase the difficulties of legislators charged with serious responsibilities, but rather to call attention to changes which, it seems to me, must be made in the plan in the interest of wise and permanent legislation. The authors of the bill having in a majority of cases accepted remedies of the character I have suggested and adopted ideas based on experience of other countries, and on sound economic principles, it is all the more to be regretted that in some of the most important provisions of the bill the lessons of experience have been ignored.

My suggestions with reference to certain provisions of the bill are made with the hope that they may prove of service to those who have the bill in charge, in their difficult task of perfecting the measure. It is certainly desirable that the American people, whose highest interests are to be affected favorably or unfavorably by Congressional action, should have as clear an understanding as possible of the nature of the proposals.

The two features of the bill which are open to the most serious objection are, first, the provisions which authorize the issue of government notes to be circulated as money and loaned on collateral security to the Federal reserve banks created by the bill; second, the provisions which create a government board which can be accurately described as a government central bank of an objectionable type. . . .

[1] Delivered before the Academy of Political Science, New York, October 15th, 1913.

Doctrine of the Bill

The theory that the United States should issue currency in the form of its promises to pay is a Populistic doctrine. It had no standing as a Democratic party principle until the advent of Mr. Bryan as its nominee for the presidency in 1896. It was injected by Mr. Bryan into the party platform in spite of the protests and against the votes of the men who had been most prominent in the party councils, men who advocated loyalty to the policies and principles to which the party had adhered throughout its existence. This greenback doctrine has never received the approval of the American people at the polls and there is every reason to suppose that it would to-day meet with their positive condemnation if the question could be submitted to a vote in a national election. It is not too much to say that the proposal in the bill came to the country as an absolute surprise. There had been no suggestion that an attempt was to be made to revive the greenback heresy or to adopt in legislation the rejected theories of the Populist party. The Democratic candidate for the presidency was silent upon the subject during the campaign, and he has not, so far as I am aware, up to this time, publicly expressed his approval of Mr. Bryan's ideas with reference to note issue. The large majority of the American people who favor sound money believed that the question of further greenback issues was settled permanently by the elections of 1896 and the following years. If the House Bill should be enacted into a law, Mr. Bryan will have achieved the purpose for which he has been contending for a decade. It would be difficult to find in history an occasion where a political dogma which had never found a permanent place in the tenets of the dominant party and which had been rejected by unanimous verdict of the civilized world could be successfully injected into a great legislative measure as a price for the support of a fraction. It is not surprising that Mr. Bryan should consider the insertion of his peculiar views into the measure we are considering as of transcendent importance. His views upon this subject throw such an important side-light upon this feature of the bill and the reasons for its incorporation that it seems to me desirable to quote them in full. In a recent letter to a member of the Banking and Currency Committee of the House of Representatives, he makes the following statement:

> The provision in regard to the government issue of notes to be issued by the banks is the first triumph of the people in connection with currency legislation in a generation. It is hard to overestimate the value of this feature of the bill.
>
> In the second place the bill provides for government control of the issue of this money—that is, control through a board composed of government officials selected by the President with the approval of the Senate. This is another distinct triumph for the people, one without which the government issue of money would be largely a barren victory.
>
> The third provision of the bill, which I regard as of first importance, is the one permitting state banks to share with national banks the advantages of the currency system proposed.
>
> These three provisions are, to my mind, of such transcending importance that I am relatively very little concerned as to the details of the bill.

The letter was written to a member of the House upon the eve of the Democratic caucus called to act upon the bill and amendments. While this frank and courageous declaration of Mr. Bryan's had the expected result of solidifying his followers in the support of the bill, it also, I venture to suggest, opened the eyes of that numerous portion of the American public, which is not and never has been in sympathy with his opinions on this subject, to the dangerous character of the proposals he commends so warmly.

The Bryan proposition as now made and accepted furnishes a plan of distribution of notes that is skilfully devised. The printing of the notes is a simple matter, but no advocate of greenback theories has heretofore been able to suggest any practical way by which they could be put in circulation. Mr. Bryan himself has not always been clear upon this point. In a speech made by him in 1894 he says:

> If it is said that we must institute banks of issue in order to put money into circulation, I answer that there is a better way. The issue of money by the government directly to the people gives us a safer money and saves to the people as a whole the profit arising from its issue. When a bank issues money you must pay the market rate of interest in order to get it, but when the government issues money the people save

the interest if the money is afterward called in, and they save the principal also if the money is kept in circulation. Numerous plans have been suggested for putting this money into circulation. Some have an idea that a government issue can only be put forth by loaning it to the people, either directly or through the agency of banks.

There are, in my judgment, other and better ways. If a limited amount is issued, and of course the amount must be strictly limited, and it is loaned to the people, partiality will be shown in its distribution, for only a few, relatively speaking, can be accommodated.

But aside from the danger of placing so great a power in the hands of the dominant party, there are plans more just and equitable than that of loaning. The money can be used to pay the expenses of the government, as the greenbacks now in circulation were used to pay the expenses of the War. If Congress decides to increase the currency a certain amount annually, say for illustration, fifty millions a year, it can reduce the tax levy to that extent and the people will receive the benefit of the issue just in proportion as they pay taxes, for they will save to that extent the taxes which they would otherwise pay.

Control of Federal Board

As I have shown, by the terms of the bill, national banks are obliged to furnish the capital and the deposits of the Federal reserve banks, the only other depositor being the United States. They are obliged to invest a part of their funds and to place a considerable part of their resources beyond their own control or to submit to a sacrifice of their property and business. This large contribution of national banks is placed under the control of political appointees, the majority of whom of necessity cannot have the knowledge or experience to qualify them for the important duties assigned to them.

The national banks are forced into the position of stockholders and principal creditors of the reserve banks. The reserve banks are forced to conduct their affairs under instructions from the central board, and yet neither the reserve banks nor the national banks are allowed to participate in any way in the management of the central board. It is not a question whether the banks are to

be permitted to control the board created to supervise their transactions, but whether they shall have any voice whatever in the management of their own property. There is nothing in our form of government, the basic principles of democracy, or the equitable principles which should govern the organization of society, which warrants any such exclusion. If this usurpation of the rights of property of protesting citizens is not without warrant in our constitution, it certainly is in violation of every principle of equity.

The attempt is made by the friends of the measure to justify this exclusion from the councils of the proposed government central bank by a reference to the means by which central banks of Europe are controlled, but a comparison of the manner in which the central banks of the three most important commercial nations of Europe are controlled with that suggested for this government central bank would show that no precedent can be found in European practice for the action contemplated in this case. The question at issue is what, if any, voice shareholders have in the management of European central banks. European central banks have no control whatever over the joint stock banks or their management.

Management of Banks

The experience of banking institutions generally establishes the fact that the best results are obtained by leaving the practical management of banking affairs to men of tried capacity and experience, whose positions are of a permanent character, and whose services in most cases command large salaries on account of the nature of their responsibilities. Successful banking on any considerable scale can be carried on only in this way. There is a clear distinction between the actual managers of a great bank, that is, those who have charge of its technical banking business and the directors who pass in a more or less perfunctory way upon the action of the managers, and who decide upon important questions of general policy affecting the bank. This distinction is rarely defined by law, but it exists in all well-managed banking institutions. It is sufficient to say that there is no important banking institution in existence that could prosper under the sole management of a political board whose membership was certain to be changed at least once in four years.

Socialistic Character of the Bill

I am aware that there seems to be a marked tendency in recent years, in some quarters, to abandon the doctrine that States have still any virile powers under our form of government, and to assent to the concentration of all powers and authority in the national government, to be exercised through Congress, or in later days, through agents of the executive. But this is, I think, the first attempt to give a government board the right to manage a great business, which is more important in its intimate relations to all the people than any other. If the attempt is successful it will be the first and most important step toward changing our form of government from a democracy to an autocracy. No imperial government in Europe would venture to suggest, much less enact, legislation of this kind.

It will be remembered that the Federal Reserve Board consists of three members of the President's official family and four others to be appointed by the President and confirmed by the Senate. One of the four members is made manager and executive officer of the Board, and acts under the supervision of the Secretary of the Treasury, who is made chairman of the Board. It is provided that not more than two of the appointed members shall be of the same political party. These provisions taken together fix the character of the Board as a political organization. Every change in administration means a change of four, and probably five, of seven members of the Board.

As I have shown, the powers granted to this central board are intended to give it the control of the functions and the business of the reserve banks by arbitrary direct, or indirect methods. It is clearly intended that the government of the United States, through these instrumentalities, shall be placed in a position where it can control and manage the banking business of the country. It is further intended that government obligations shall ultimately take the place of all other forms of note issues. This general purpose is either illy concealed or openly announced by the promoters and advocates of the plan.

I feel sure that it is not necessary to remind *the Senate Committee* who have the responsibility of recommending proper legislation

upon this subject, that no credit can attach to any Congress or administration unless the legislation adopted shall prove wise and effective. The features of the bill to which I have called attention are of such a character that they should not be accepted. I have tried to show that *the House Bill* has serious defects. It appeals to the Populists of adopting their plan of note issues; to the socialists by seeking to place the management of the most important private business of the country in the hands of the government; it seeks the support of bankers in great centers by its unexpected discrimination in their favor, but its dangerous doctrines and unwise methods do not appeal to the sound judgment of the American people. The bill as it stands with its partly ineffective and partly dangerous provisions would be detrimental to the interests of banks, with the exception, perhaps, of the great banks in the central reserve cities. Its objectionable features have neither the support of public opinion nor the approval of the banking fraternity. They are contrary to the teachings of political economists and they are not supported by the judgment of practical men. Its immediate enactment is urged by its sponsors upon the plea that it will create confidence and furnish remedies. It just falls short in its beneficial features of accomplishing a wise purpose, and by the radical character of its objectionable provisions it threatens to upset business and to produce the evil results which it was projected to cure. Its authors have not ignored the lessons of experience, but are apparently afraid to make their legislation conform to its teachings, on account of the declaration of a party platform.

APPENDIX TWENTY-EIGHT

TESTIMONY BEFORE THE RESERVE BANK ORGANIZATION COMMITTEE IN JANUARY, 1914

In trying to divide the United States into eight Federal reserve districts, we are meeting a peculiar problem. The little corner on the map embracing New York, New England, and Pennsylvania would contain $800,000,000 of national bank capital and surplus, as compared to a total of the United States of $1,700,000,000, and if we draw a line from north to south, ending in Kansas City, and a line from there through St. Louis to the east, we find that this sector, which is less than a sixth of the area of the whole United States, would contain $1,250,000,000 as against the total of $1,700,000,000.

This shows clearly the difficulty we meet in organizing the remaining territory outside of this sector, for in order to cover five-sixths of the entire territory of the United States, there are left only $450,000,000 of national banking power. Of these, $80,000,000 would belong to California and about $30,000,000 to Washington and Oregon, so that for the whole remaining territory, namely twenty-six of the geographically largest States, there remains only a national banking power of $340,000,000.

Six per cent of these $340,000,000 would produce $20,000,000 of Federal reserve capital, if fully paid, and these $20,000,000, out of $102,000,000 would have to cover the two Virginias, the two Carolinas, Kentucky, Tennessee, Alabama, Georgia, Florida, Mississippi, Louisiana, Arkansas, Oklahoma, part of Kansas, Texas, New Mexico, Arizona, Colorado, Utah, Nevada, Idaho, Montana, Wyoming, Nebraska, and North and South Dakota.

This admits of several conclusions:

First, that the financial preponderance of the northeastern angle of the United States is such that no matter how the country will be divided, it will have to rely for its financing largely upon the banking power of this section of the country.

Second, this being so, that the fluidity of credit which will follow the development of discount markets and which this law is destined to bring about, must depend upon the strength and efficient organization of this section, and that, consequently, any attempt artificially to reduce this strength would of necessity weaken the entire structure.

Third, that in constructing the Federal reserve banks, care should be taken that the centers of each district are situated towards the eastern border of the western districts, and rather towards the northern border of the southern districts, because financially and commercially, the direction must of necessity be towards the financial center; and from an administrative point of view, it is important that these branches be within the nearest possible reach of Washington. The distance to be covered by each head of a Federal reserve bank or by the members of the Federal Reserve Board should be reduced to a minimum, as far as feasible, whereas members of the branches lying further to the west or south would have to carry the burden of traveling a little further east or north to the meetings of the Federal reserve banks. For clearings and transfers it will be equally important that the letter travel in the right direction which, in the majority of cases, will be to the east and north.

Leaving aside for a moment these general questions of principles upon which to proceed, I believe that the best way of approach would be to begin with California, and to establish at the outset which of the States are to become tributaries to the Federal Bank of San Francisco. In particular we must then determine whether Washington and Oregon are to be headed south or east, and whether Nevada and Arizona are to be headed west or east. I believe the Pacific Coast will have to be treated as an entirely distinct district which generally will take care of itself. As far as San Francisco and her territory is concerned, branches of course will have to head towards that city, and the theory of having the remaining country gravitate towards the northeastern angle would not apply to this district.

After having decided upon the constitution of the Pacific Coast Federal Reserve District, I believe the next step would be to

establish how far it is possible to let the banking power of the northeastern angle radiate into the poorer districts.

Drawing a line from St. Louis through Denver and following the Mississippi from St. Louis south, we might construct the Federal Reserve District of St. Louis which would include all the States covered by that angle, excepting Louisiana and the territory allotted to San Francisco. This would give that district an approximate national banking power of $193,000,000. Taking the eastern border-lines of Illinois and Wisconsin as the border-line for the northwestern Federal Reserve District of Chicago, we would include in that district all the northwestern States situated north of the St. Louis-Denver line, excepting those allotted to the San Francisco district.

The question of the New Orleans district is a perplexing one, because New Orleans does not lie in the right line of concentration. It is situated too far south, and all concentration that would take place by way of clearings, communications, or by way of meetings of members of branches at New Orleans, would lead away from the northern course which, in most cases, would be their natural direction. For instance, Atlanta and Savannah would naturally tend north for their trade and not south.

I am therefore rather inclined to conclude that New Orleans should not be a head-office but a branch, and that the head-office should be further north. How far that should be, and where located, is difficult to decide. It would be desirable to extend the southern district as far north as possible, so as to draw into it some part of the richer North. Part of Kentucky and the two Virginias might be included and form the northern border of the southeastern district. It has been suggested that this Federal reserve bank might be located in Washington, which would have some advantages, but the disadvantage would be that Washington is not a commercial center and that the Federal Reserve Board would naturally be under the daily influence of this southeastern wing, while the Federal Reserve Board might prefer to be in a more protected position. It might prove the better solution to make Richmond the Federal reserve bank place or to include Maryland in the southeastern district and make Baltimore the seat of the Federal reserve bank.

There remains to be considered the organization of the northeastern angle:

The strongest system would of course be secured if all this territory were to constitute one district, because this would form the basis of a system of enormous strength. Inasmuch, however, as there still remain four Federal reserve banks to be placed, this remainder of the country will have to be divided into four districts. If it should be found feasible to divide the South into two districts, this northeastern corner could be divided into three districts only, and the fewer the northeastern districts, the stronger the entire system.

In order to divide the northeastern corner into four districts, one Federal reserve district might include Michigan, Indiana, and Ohio, to which probably ought to be added all, or at least the northern part, of Kentucky. In this case the Federal reserve bank would probably be located at Cincinnati. If Kentucky should be left out, Cleveland might have a claim upon the seat of the Federal reserve bank.

The next Federal reserve bank, the sixth, would be that of Philadelphia, including Pennsylvania, Maryland, and Delaware, and the southern part of New Jersey. The State of New York, Connecticut, and the northern part of New Jersey would form the seventh, and the New England States without Connecticut would form the eighth Federal reserve bank.

In order to render feasible the division of the country into districts, having each at least a certain intrinsic financial power, New York has been reduced to such a degree, under this plan, that two of the large New York banks would each have resources of about twice the amount of the fully paid capital stock of the New York Federal Reserve Bank. This is an anomalous condition which should be remedied as much as possible, because at home and abroad the System would gain in dignity and efficiency if the New York district could receive a larger allotment of territory. This could be brought about if it should be thought advisable to divide the southeastern territory into two districts, or if an additional district in the West should be created, in case it should be found that Oregon and Washington would prefer to tie up with Minneapolis rather than with San Francisco. While this would

remove the necessity of establishing too many units in the Northeast, the damage done by so drastically cutting up this territory might greatly be reduced if care were taken not to interfere thereby with the stability and financial power of this northeast corner. For, if it should not be possible to develop in due course, some discount markets in this territory, there is not the least hope of ever developing this system in the remainder of the country. Moreover, this difficulty must be overcome, that by creating so large a number in this northeast corner, the Federal Reserve Board might find it extremely hard to handle the questions that will come up before it for decision.

From this point of view it is very desirable that, in an administrative way, the Federal reserve banks should be grouped in five large divisions. There would be a northeastern division, containing the Federal Reserve Banks of New England, New York, and Philadelphia; a northwestern division, containing Chicago and Cincinnati; a southeastern division, containing New Orleans, with a Federal reserve branch at a more northern point to be decided upon, possibly Richmond or Baltimore; a southwestern division, with head office at St. Louis; and the Pacific division, including Hawaii and Alaska.

The Federal Reserve Board would naturally desire to divide its functions and would probably allot each division to one particular member of the Board, the Comptroller of the Currency being in charge of examinations, auditing, supervision in general, and of note issue in particular. In order to enable the Federal reserve banks of the northeastern angle to develop any kind of joint discount policy which would be necessary to build up a discount market, it might prove advisable that New York, Boston, and Philadelphia form a committee of their own, and Chicago and Cincinnati form a similar body. Such committees would discuss questions of policy and of mutual assistance between the two or three Federal reserve banks, respectively. If the Federal Reserve Board would want to call upon the northeastern States, or the northwestern States for any rediscount operation in favor of any other Federal reserve district, it would communicate with these committees, and it would be left with each of these to apportion among its constituents the amount to be rediscounted

by each Federal reserve bank. In case of disagreement among these Federal reserve banks, the Federal Reserve Board itself would decide how to apportion the amounts to be rediscounted. I believe that by a simple arrangement of this kind the objects of the legislation, which are the development of the fluidity of credit and the creation of discount markets, would be greatly helped. Because by adopting this method coöperation could be secured among various financial districts and autonomy would be safeguarded to a certain degree, the lack of which might otherwise prevent the necessary degree of confidence in the stability of power of the organization, most essential prerequisites for a successful operation of the System.

When publishing the weekly statements of each Federal reserve bank, a joint status of each division should be published in addition to one showing the condition of all divisions combined. In this way not only a clearer picture would be given, which will be less confusing than the statement of eight separate Federal reserve banks, but at home and particularly abroad the larger figures will create more confidence and will be better understood.

If either the Southeast or the Northwest should be divided into two sections, these would of course form one administrative division and operate exactly on the same lines as here suggested for the Northeast.

It may be profitable at this point to review our conclusions from an angle from which we have not yet considered the subject.

We have dealt so far only with the problem of adequate distribution of banking power and of geographic location. We must not overlook, however, that the ideal division of territory must provide for regions containing the largest possible variety of interests (that is, varied branches of industry and production), and at the same time the largest possible similarity of interest rates. As suggested in the two tables,[1] here attached, the distribution of territory would comply, as far as feasible, with the first of these requirements. But there would be great difficulty in finding one rate of discount that could effectively govern at the same time Baltimore and New Orleans, or St. Louis and San Antonio, or Chicago and some of the far western points. It would not be difficult to find a "bank rate" governing at the same time Boston,

[1] Not reprinted.

New York, and Philadelphia, and it may be expected that Illinois and the Cincinnati district would often be governed by the same rate as this eastern group. That is why this northeastern angle lends itself to the development of discount markets, and that is why it is most important to group it so that it may be treated, administratively at least, in large units.

The difficulty that we meet, as in the case of Baltimore and New Orleans, might be overcome in two ways:

One method would be to clearly state from the beginning that different rates may be established for the various branches within one Federal reserve bank district. The law would permit this inasmuch as it provides that the Federal reserve banks shall have power: "to establish from time to time . . . *rates* of discount to be charged by the Federal reserve banks for each class of paper." And, furthermore, "The branches shall be operated by a board of directors under rules and regulations approved by the Federal Reserve Board."

If the Organization Committee proceeds on this theory, there is no objection to large districts containing wide variations of interest rates. Should, however, the opposite view prevail—which the writer hopes may not be the case—then it would become necessary to divide the Baltimore district in two, with Maryland, District of Columbia, the two Virginias, and Kentucky to constitute the northern half of the southeastern division, having a banking power of about $108,000,000, and constituting Louisiana, Mississippi, Alabama, Florida, Georgia, and North and South Carolina into the southern half of the division, with a banking power of $96,000,000.

The northwestern and the southwestern districts would have to be dealt with in a similar way. It might be found advisable to treat these geographically large, but financially small, States in the same manner as the geographically small, but financially large, northeastern districts. That is: to have these geographically large districts covered in their entirety by one Federal reserve bank, but to subdivide them administratively into sub-districts governed by committees.

It will be easier to give a positive opinion concerning these questions when it will have been stated on authority which of the

two policies is to be adopted, that of having *one* rate for an entire district, or that of possible differentiation between the various branches.

In venturing to submit these ideas, I hope they will be looked upon as suggestions only, and only as rough outlines. I am fully aware of the fact that State lines cannot be observed in many cases where I have dealt with the States.

Specific knowledge of local conditions, such as the Organization Committee is about to acquire, is apt to lead to a modification in many respects of the thoughts here expressed.

Respectfully submitted,

P. M. W.

APPENDIX TWENTY-NINE

REVISED REPORT OF THE FEDERAL RESERVE BOARD COMMITTEE ON REDISTRICTING

Washington,
November 17th, 1915

To the Federal Reserve Board:

There are now pending for consideration by the Board the following appeals from decisions of the Reserve Bank Organization Committee, regarding the determination of Federal reserve cities and district lines:

First. The appeal of Baltimore that it be selected in preference to Richmond as the Federal reserve city of the Fifth District;

Second. The appeal of Pittsburgh that it be selected in preference to Cleveland as the Federal reserve city of the Fourth District;

Third. The appeal of a group of banks in certain counties of Wisconsin that they be taken out of the Minneapolis District and added to the Chicago District;

Fourth. The appeal of certain banks in the western half of Connecticut that they be taken out of the Boston District and added to the New York District; (the Board has not fixed the time for hearing this appeal).

Fifth. The appeal of certain banks of Louisiana that they be included in the Atlanta District and operate through the New Orleans branch, in preference to being included in the Dallas District. (This appeal has not been heard by the Board, but the facts of the case are being investigated.)

Your Committee recommends that these five cases be dealt with in a comprehensive way by considering the broader question of readjustment of districts.

We may assume that among the important objects which Congress desired to achieve in enacting the Federal Reserve Act were:

1. The creation of independent banking centers—indeterminate in number and regional rather than local in character—in each of which would be concentrated a substantial portion of the banking reserves of its district which could be effectively utilized as the basis of an elastic system of credit and note issue and which would create and sustain a ready market for commercial paper and bankers' acceptances.

2. The steadying of interest rates by more nearly equalizing the supply of credit facilities in different parts of the same district or between districts, more particularly by making available for active use where needed, funds which might otherwise or elsewhere be unemployed.

3. The establishment of an economical and efficient system of clearings and collection of checks and of transferring funds within or between districts.

Decentralization of credit facilities through the agency of the great and strong regional centers, subject to centralized supervision, is the plan of organization which differentiates the Federal Reserve System from any other comparable banking system, and the success of our new American departure in the field of management of a system of reserve banking will be conditioned upon the wisdom and discrimination with which this plan of administration is applied. Abundant evidence is to be found, both in the debates of Congress and in the Reserve Act itself, that the framers of the Federal Reserve Act were fully alive to this fact, but it is necessary to recognize and emphasize that however much importance the framers of the Act attached to the choice of suitable divisions in the effective administration of the System, the Act, nevertheless plainly regarded this as a question which could not be settled in advance and a question that could not even be definitively settled by the Reserve Bank Organization Committee on the basis of such investigation as could be had before the actual inauguration of the new banking system. The Act, therefore, did not undertake to fix the boundaries of districts nor even the exact number. Congress was satisfied to prescribe an upper and a lower limit within which the precise number of districts should be determined in accordance with changing conditions and after the necessary experience might be at hand. The ultimate judgment on this important question was to

be that of the Federal Reserve Board, and Congress did nothing to impede the free exercise of the Board's judgment on this question other than laying down the requirements that the districts should not be more than twelve in number nor less than eight, and by prescribing that due regard should be given to the "convenience and customary course of business."

Observation of the actual working of the Federal Reserve Banking System and of the factors that make for strength and for weakness, has satisfied your Committee that there is a limit in the present circumstances of the country, beyond which decentralization may defeat its purpose without making for independence. Experience has satisfied us that the fundamental purpose of decentralization as well as the other important objects of the Reserve System, will never be attained in the degree which your Committee believes possible without at least a partial consolidation of certain now contiguous districts. The Reserve Bank Organization Committee to whose judgment in the first instance the question of fixing the number and boundaries of the Federal reserve districts was referred, did not have and could not have had the data, which alone could be derived from experience, necessary for a final disposition of the problem. Its conclusions were necessarily more or less conjectural in character and, therefore, not to be regarded, under any reasonable construction of the authority and responsibilities of the Federal Reserve Board in the matter, as final. It may be assumed that the Act, in referring the problem of districting along with other preliminary questions to the Organization Committee for initiative action, did so with full appreciation of the difficulties and the importance of the problem and in order not to delay the organization of the Federal reserve banks by postponing consideration of the question until after the appointment of the Federal Reserve Board;[1] and this method of handling the problem was doubtless also adopted by Congress in full appreciation by it of the fact that in its first stages the whole reserve banking organization would be so flexible in character that such readjustments in the fundamentals of the regional structure, as might commend themselves as necessary or expedient to the judgment of the Federal

[1] See speech of Hon. Carter Glass, December 22nd, 1913, on the Conference Committee report on the Federal Reserve Act.

Reserve Board, could be made without injury to or impairment of the normal development of the System.

In organizing the new banking system it was obviously necessary to begin at some point, even though it was to be expected that some of the action taken would have to be revised. The task of the Organization Committee was of necessity one beset with many and varied difficulties and uncertainties. No one can appreciate this better than your Committee which, in reviewing the problem of districting, has had the advantage of much definite knowledge derived from experience which was lacking to the Organization Committee. It therefore implies no criticism of the work and findings of the Organization Committee if your present Committee, with the benefit of a year's observation of the workings of the Federal Reserve System has reached the conclusion that the regional structure outlined by the Organization Committee can be simplified in some of its features with a gain in efficiency and economy of operation. It is, indeed, a tribute to the insight exercised by the Organization Committee in laying out the boundaries of the reserve districts, that the readjustments considered necessary by your Committee should be found to involve so little change in the fundamental lines of the Organization Committee's map. Opinions, it may well be expected, will long differ as to the best alignment of districts under the Federal Reserve System. However much experience may do to help the solution of the problem, experience alone may not for a very long time, perhaps never, be expected to settle it. There will always be a considerable margin of doubt on points of detail which will have to be resolved by the unaided judgment of the Board. It is true that all the data which may in time be expected to become available, are not yet at hand for a final and definitive solution of the problem if experience alone is to settle it, but your Committee is of the opinion that there has already been sufficient experience to make it possible to undertake the work of readjustment with intelligence and substantial confidence in the permanency of the results. Any risks of possible necessary readjustments of a minor character in the future are to be regarded as slight and negligible compared with the injury possibly to be done through holding back the development of the Federal Reserve System and keeping the business and

banking communities of the several districts in a state of suspense as to what will be the final disposition of the districting question, to say nothing of the considerable dislocation and disturbances in established arrangements which every additional day of delay will entail.

Speaking practically, therefore, on the question of readjustment of districts, your Committee is firmly of the opinion that so far as any large and comprehensive handling of the problem is concerned, it is a question of *now or never!* The time has come when the Federal Reserve Board must either accept the responsibility of sanctioning the existing arrangement of districts or else of making in the near future such revision as in the exercise of its best judgment it now believes to be necessary.

The problem is preëminently one for the exercise of general judgment as to what will make for the most effective organization of the Federal Reserve Banking System and your Committee does not, therefore, think it necessary to develop at length or in detail the reasons which have weighed with its individual members, each of whom has reached his conclusions in his own way. Attention may, however, be called to some of the considerations in favor of a reduction in the number of districts. Some of these which recommend themselves on the ground of business efficiency are so obvious as not to require extended reference. They are the increased economy of operation that would result from diminished overhead expenses, diminished costs of issue and redemption of notes, etc. But however important these and similar considerations of a strictly business nature, there are, in the opinion of your Committee, administrative advantages of a large and compelling character that would result from a well conceived readjustment of the districts.

1. The Federal Reserve System is still in the developmental stage; the test of its capacity is still to come. The primary responsibility for making it a success rests with the Federal Reserve Board. In the opinion of your Committee, experience already shows the embarrassment which the Board may expect in dealing with and through units that are weak. Effective decentralization of banking facilities, we believe, depends not merely upon the number of Federal reserve banks but upon the vigor with which

they function. To achieve the purposes of the Act the component units of the Federal Reserve System must be strong enough in themselves to be effective, large enough to command respect, and active enough to exert a continuous and decisive influence in the banking affairs of its district. This means that in the less well developed and settled parts of the country a well constructed district must embrace a territory sufficiently wide in extent and diversified in its interests to give balance to its banking situation, and not too much tied up to a single crop or line of industry, and that every district should be free from any suggestion of sectionalism.

2. A reduction in the districts will help the working out of the check-clearing and collection problem by securing a Subtreasury in every district as well as by reducing the overhead expense and hence, overcoming one of the obstacles to the undertaking.

3. Last and perhaps most important we must not let the fact that the Reserve Banking System has gone through the first year of its operation without any untoward event in its life, mislead or deceive us as to the future. We should, as a Board, be unworthy of our responsibilities if we did not realize that severer tests than any to which the System has yet been exposed might be expected. Sooner or later this test will come and when it comes it will come with a suddenness and abruptness for which we must now prepare. Economists and financiers are not agreed as to precisely what the situation will be when the War is over. That the world will be confronted with a gigantic problem in industrial, commercial, and financial reconstruction as a result of the disorganization of credit, commerce, and industry wrought by the War and the destruction of life and property is, however, agreed. No one can pretend at this time to calculate with accuracy the extent of the shock to which our banking and credit system will be subjected, but it is certain to be of extraordinary severity and extent. Readjustments in the world of commerce and finance such as the world has not seen since the close of the Napoleonic wars will have to be worked out and we, as a nation, must be ready to meet alike the necessities and the opportunities of the new and changed situation, and for this purpose our chief reliance must be the perfected Federal Reserve System. This means, in the judgment of your Committee,

that all the several reserve banks must be made capable and strong, able and accustomed to act with promptness, with vigor, with intelligence, and when necessary, in concert with one another, and in subordination to broadly conceived policies national in their scope and purpose.

Of the twelve Federal reserve banks one half may be said to be strong and the other half weak. The remedy for this situation, in the opinion of your Committee, is such a readjustment of the districts as will leave us with perhaps eight or nine districts, all of adequate extent and banking power and each able to support a strong and active regional center. Your Committee has reached this conclusion only after much reflection and not without consideration of the obstacles, legal, political, and administrative, which will be encountered in working out a program along the lines indicated. It is our belief that the members of the Federal Reserve Board will not be deterred from fidelity to their higher and more difficult responsibilities by any adventitious considerations, or by local and personal sympathies. It ought therefore, in our opinion, to be possible for the Board to act in substantial if not complete accord on this question if we keep steadily in mind the best development of the Federal Reserve System and set our loyalty to the System above and beyond any other. Both the Federal Reserve Board and the Federal reserve banks are still on trial before the bar of public opinion, and advantage will be taken of every real or imagined difference of opinion in the Board by its critics and the enemies of the Federal Reserve System. We should not hesitate, however, because of this difficulty; promptness and unanimity of action is the way to meet it.

What Congress had in mind when it made the provision that the Federal Reserve Board might add to the number or reclassify the cities heretofore classified as reserve and central reserve cities is evident and it seems reasonable to draw the conclusion, in view of the differences in reserve requirements, that cities of sufficient importance as banking centers to be named Federal reserve centers should also be classed as central reserve cities and their reserve requirements raised to 18 per cent; whereas, cities which from their geographical position and rank in the banking world

might be classed as branches of Federal reserve banks, should be classed as reserve cities.

To accept this reasoning and adopt this grouping of the cities would not only strengthen the reserve banks by increasing their reserve deposits, but would also effectively inhibit cities without adequate banking status from seeking the benefits of recognition as Federal reserve cities, without being willing to accept the burdens and responsibilities which should be a necessary concomitant of the privilege. Your Committee believes that such a rule should be adopted by the Board and that it would go far toward facilitating any readjustment of the districts.

Your Committee, having presented the case for redistricting in its general aspects, before making further report and submitting a definite program asks instructions on the following:

(*a*) Shall the Committee prepare and submit a plan of changes in district boundaries involving the consolidating of adjoining districts and reduction in the number of districts?

or

(*b*) Shall the Committee proceed to recommend answers to each of the five cases now on appeal before the Board without touching the larger issues involved in a comprehensive handling of the redistricting problem?

Respectfully submitted,

Committee { F. A. Delano
P. M. Warburg
W. P. G. Harding

Appendices attached.

SUB-APPENDIX 1

NAME OF CITY	AGGREGATE CAPITAL AND SURPLUS OF MEMBER BANKS SEPT. 2, 1915	3 PER CENT OF CAPITAL AND SURPLUS OF MEMBER BANKS SEPT. 2, 1915	PER CENT OF SHARE OF CAPITAL OF F. R. BANK PAID-IN BY MEMBER BANKS IN CITIES NAMED	PER CENT OF SHARE OF TOTAL PAID-IN CAPITAL OF ALL F. R. BANKS
1. Boston, Mass.	$57,071,000	$1,712,130	33.2	3.1
Worcester	2,750,000	82,500	1.5	.1
Lowell	1,600,000	48,000	.9	.1
Springfield	3,200,000	96,000	1.9	.2
Fall River	3,025,000	90,750	1.8	.2
Haverhill	1,930,000	57,900	1.1	.1
Holyoke	1,800,000	54,000	1.0	.1
New Haven, Conn.	6,820,000	204,600	4.0	.3
Hartford	5,950,000	178,500	3.5	.3
Concord, N. H.	1,150,000	34,500	.7	.1
Portsmouth	540,000	16,200	.3	.0
Manchester	1,300,000	39,000	.8	.1
Keene	1,100,000	33,000	.6	.1
Providence, R. I.	8,850,000	265,500	5.1	.5
Portland, Maine	3,125,000	93,750	1.8	.2
Total, Above Cities	100,211,000	3,006,330	58.2	5.5
Total for District	172,409,385	5,172,282	100.0	9.4

Sub-Appendix 2

Name of City	Aggregate Capital and Surplus of Member Banks Sept. 2, 1915	3 Per Cent of Capital and Surplus of Member Banks Sept. 2, 1915	Per Cent of Share of Capital of F. R. Bank Paid-in by Member Banks in Cities Named	Per Cent of Share of Total Paid-in Capital of All F. R. Banks
2. New York City	243,425,000	7,302,750	66.4	13.3
Buffalo	12,100,000	363,000	3.3	.7
Rochester	4,275,000	128,250	1.2	.2
Syracuse	4,235,000	127,050	1.2	.2
Albany	4,300,000	129,000	1.2	.3
Jersey City, N. J.	2,200,000	66,000	.6	.1
Hoboken	1,060,000	31,800	.3	.1
Newark	10,644,000	319,320	2.9	.6
Total, Above Cities	282,239,000	8,467,170	77.1	15.5
Total for District	364,526,860	10,935,806	100.0	20.0
3. Philadelphia, Pa.	61,480,000	1,844,400	35.0	3.4
Scranton	6,200,000	186,000	3.5	.3
Reading	4,750,000	142,500	2.7	.3
Wilkes-Barre	3,750,000	112,500	2.2	.2
Allentown	2,725,000	81,750	1.6	.1
Lancaster	2,332,000	69,960	1.3	.1
Chester	1,985,000	59,550	1.1	.1
York	1,953,000	58,590	1.1	.1
Johnstown	1,800,000	54,000	1.0	.1
Wilmington, Del.	1,203,175	36,095	.7	.1
Total, Above Cities	88,178,175	2,645,345	50.2	4.8
Total for District	175,398,550	5,261,956	100.0	9.6

Sub-Appendix 3

Name of City	Aggregate Capital and Surplus of Member Banks Sept. 2, 1915	3 Per Cent of Capital and Surplus of Member Banks Sept. 2, 1915	Per Cent of Share of Capital of F. R. Bank Paid-in by Member Banks in Cities Named	Per Cent of Share of Total Paid-in Capital of All F. R. Banks
4. Cleveland, O.	$14,400,000	$432,000	7.3	.8
Cincinnati	20,550,000	616,500	10.4	1.1
Pittsburgh, Pa.	46,460,000	1,393,800	23.4	2.6
Washington	2,209,000	66,270	1.1	.1
Erie	2,050,000	61,500	1.0	.1
Total, Above Cities	85,669,000	2,570,070	43.2	4.7
Total for District	198,020,096	5,940,603	100.0	10.9
5. Richmond, Va.	9,885,800	296,574	8.8	.6
Baltimore, Md.	19,005,710	570,171	16.9	1.0
Washington, D. C.	12,669,250	380,077	11.3	.7
Total, Above Cities	41,560,760	1,346,822	37.0	2.3
Total for District	111,645,470	3,349,364	100.0	6.1
6. Atlanta, Ga.	8,600,000	258,000	10.7	.5
Bimingham, Ala.	3,300,000	99,000	4.1	.2
New Orleans, La.	6,730,000	201,900	8.3	.3
Total, Above Cities	18,630,000	558,900	23.1	1.0
Total for District	80,408,747	2,412,262	100.0	4.4
7. Chicago, Ill.	74,975,000	2,249,250	34.0	4.1
Indianapolis, Ind.	9,730,000	291,900	4.4	.5
Milwaukee, Wis.	9,800,000	294,000	4.4	.5
Detroit, Mich.	10,250,000	307,500	4.6	.6
Total, Above Cities	104,755,000	3,142,650	47.4	5.7
Total for District	221,263,906	6,637,917	100.0	12.1

Sub-Appendix 4

Name of City	Aggregate Capital and Surplus of Member Banks Sept. 2, 1915	3 Per Cent of Capital and Surplus of Member Banks Sept. 2, 1915	Per Cent of Share of Capital of F. R. Bank Paid-in by Member Banks in Cities Named	Per Cent of Share of Total Paid-in Capital of All F. R. Banks
8. St. Louis, Mo.	38,640,000	1,159,200	41.4	2.1
Louisville, Ky.	7,700,000	231,000	8.2	.4
Total, Above Cities	46,340,000	1,390,200	49.6	2.5
Total for District	92,670,447	2,780,113	100.0	5.1
9. Minneapolis, Minn.	16,960,000	508,800	20.0	.9
St. Paul	10,100,000	303,000	12.2	.6
Duluth	3,950,000	118,500	4.7	.2
Total, Above Cities	31,010,000	930,300	36.9	1.7
Total for District	84,704,850	2,541,145	100.0	4.6
10. Kansas City, Mo.	13,556,000	406,680	13.5	.7
Omaha, Neb.	8,235,000	247,050	8.2	.5
Denver, Colo.	7,288,000	218,640	7.2	.4
Total, Above Cities	29,079,000	872,370	28.9	1.6
Total for District	101,089,245	3,032,677	100.0	5.6
11. Dallas, Tex.	7,271,500	218,145	7.9	.4
Ft. Worth	4,300,000	129,000	4.7	.2
Houston	7,250,000	217,500	7.9	.4
Galveston	800,000	24,000	.9	
San Antonio	3,840,000	115,000	4.1	.2
Total, Above Cities	23,461,500	703,845	25.5	1.2
Total for District	91,991,961	2,759,759	100.0	5.0

Sub-Appendix 5

Name of City	Aggregate Capital and Surplus of Member Banks Sept. 2, 1915	3 Per Cent of Capital and Surplus of Member Banks Sept. 2, 1915	Per Cent of Share of Capital of F. R. Bank Paid-in by Member Banks in Cities Named	Per Cent of Share of Total Paid-in Capital of All F. R. Banks
12. San Francisco, Cal.	45,185,000	1,355,550	34.5	2.5
Seattle, Wash.	5,390,000	161,700	4.1	.3
Portland, Ore.	7,900,000	237,000	6.0	.5
Los Angeles, Cal.	9,775,000	293,250	7.5	.5
Salt Lake City, Utah	3,280,000	98,400	2.5	.2
Total, Above Cities	71,530,000	2,145,900	54.6	4.0
Total for District	131,435,490	3,943,065	100.0	7.2
Total for Member Banks in Specified Cities	922,663,435	27,679,902		50.5
Total for Member Banks in All Reserve Cities	814,999,450	24,549,983		44.8
Total for Country Banks	1,010,565,557	30,216,967		55.2
Total for All Member Banks	1,825,565,007	54,766,950	100.0	100.0

Sub-Appendix 6

LIST OF CITIES SHOWING PERCENTAGE OF CAPITAL WHICH THEIR MEMBER BANKS BEAR TO THE ENTIRE CAPITAL OF THE FEDERAL RESERVE SYSTEM

(Cities are listed in accordance with percentage of their capital in the Federal Reserve System)

Rank		Percentage	Rank		Percentage
1.	New York	13.3	18.	Richmond	.6
2.	Chicago	4.1	19.	Milwaukee	.5
3.	Philadelphia	3.4	20.	Los Angeles	.5
4.	Boston	3.1	21.	Indianapolis	.5
5.	Pittsburgh	2.6	22.	Providence	.5
6.	San Francisco	2.5	23.	Atlanta	.5
7.	St. Louis	2.1	24.	Omaha	.5
	(Minneapolis and St. Paul combined)	1.5	25.	Portland, Ore.	.5
8.	Cincinnati	1.1	26.	Louisville	.4
9.	Baltimore	1.0	27.	Denver	.4
10.	Minneapolis	.9	28.	Dallas	.4
11.	Cleveland	.8	29.	Houston	.4
12.	Kansas City	.7	30.	New Haven	.3
13.	Washington, D. C.	.7	31.	New Orleans	.3
14.	Buffalo	.7	32.	Scranton	.3
15.	Newark	.6	33.	Hartford	.3
16.	Detroit	.6	34.	Seattle	.3
17.	St. Paul	.6	35.	Reading, Pa.	.3
			36.	Albany, N. Y.	.3

APPENDIX THIRTY

OPINION OF T. W. GREGORY, ATTORNEY GENERAL, CONCERNING THE POWER OF THE FEDERAL RESERVE BOARD TO ABOLISH ANY OF THE EXISTING FEDERAL RESERVE DISTRICTS NOVEMBER 22, 1915[1]

DEPARTMENT OF JUSTICE

Washington, November 22nd, 1915

SIR:

I have your letter transmitting a request from the governor of the Federal Reserve Board for my opinion as to the power of the Board to *abolish* any of the existing Federal reserve districts or Federal reserve banks. The Secretary of the Treasury, who is *ex officio* chairman of the Board, unites with the governor in making this request; and you ask that I comply with it.

The Act creating the Federal Reserve System (38 Stat., 251, ch. 6) provided for an "Organization Committee" to be composed of the Secretary of the Treasury, the Secretary of Agriculture, and the Comptroller of the Currency (sec. 2).

The Act also established a permanent body known as the "Federal Reserve Board" (sec. 10).

A reading of the Act shows at once that the Organization Committee was created not merely for the purpose of attending to the formalities of organization or to serve as a stop-gap until the Federal Reserve Board should come into existence, but that it had an independent function to perform and to that end was invested with wide powers. That is to say, its function was to *organize* the System as contradistinguished from the function of the Federal Reserve Board, which was primarily to *administer* the System.

This being the general scheme, the Act provided that the Or-

[1] *Federal Reserve Bulletin*, Vol. 1.

ganization Committee, "as soon as practicable, . . . shall designate not less than eight nor more than twelve cities to be known as Federal reserve cities, and shall divide the continental United States, excluding Alaska, into districts, each district to contain only one of such Federal reserve cities" (sec. 2).

It provided further that these districts—

"shall be apportioned with due regard to the convenience and customary course of business, and shall not necessarily be coterminous with any State or States."

And—

"shall be known as Federal reserve districts, and may be designated by numbers" (sec. 2).

In order that it might have the information and advice essential to the discharge of this duty the Organization Committee was authorized—

"to employ counsel and expert aid, to take testimony, to send for persons and papers, to administer oaths, and to make such investigation as may be deemed necessary by the said committee in determining the reserve district and in designating the cities within such districts where such Federal reserve banks shall be severally located" (sec. 2).

Upon the establishment of the Federal reserve districts by the Organization Committee a certificate must be filed with the Comptroller of the Currency—

"showing the geographical limits of such districts and the Federal reserve city designated in each of such districts" (sec. 4).

Having thus authorized the Organization Committee to designate Federal reserve cities and to create around each a Federal reserve district, the Act directed that—

"the said committee shall supervise the organization in each of the cities designated of a Federal reserve bank" . . . (sec. 2).

The Act then prescribes how these banks shall be constituted:

Every national bank is required to subscribe to the capital stock of the Federal reserve bank of its district in a sum equal to 6 per cent of its paid-up capital stock and surplus, one-sixth payable on the call of the Organization Committee or of the Federal Reserve Board, one-sixth within three months, and one-sixth within six months, the remainder subject to call by the Federal Reserve Board

when deemed necessary (sec. 2). State banks declared eligible by the Organization Committee, while of course not required to subscribe, were authorized to do so (secs. 2, 4).

If the subscriptions by banks to the stock of any Federal reserve bank in the judgment of the Organization Committee do not provide an adequate capital, the Organization Committee may offer the stock of such Federal reserve bank to public subscription; and if the total subscriptions by banks and the public fall short of supplying an adequate capital, the Organization Committee shall allot to the United States such an amount of the stock of the Federal reserve bank in question as the committee shall determine. Stock not held by banks has no voting power (sec. 2).

No Federal reserve bank is permitted to commence business with a subscribed capital of less than $4,000,000 (sec.2), nor until authorized so to do by the Comptroller of the Currency (sec. 4).

When the minimum amount of capital stock required for the organization of any Federal reserve bank shall have been subscribed, the Organization Committee is directed to designate any five of the subscribing banks to complete the organization and to execute and file with the Comptroller of the Currency a certificate of organization, stating the name of such Federal reserve bank, the city and State in which it is located, the territorial extent of the district in which its operations are to be carried on, the amount of its capital stock and the number of shares into which the same is divided, the name and place of business of each bank executing the certificate of organization and of each subscribing bank and the number of shares subscribed by each, etc. (sec. 4).

Upon the filing of this certificate such Federal reserve bank becomes a body corporate, with the powers which are enumerated, amongst them the power—

"to have succession for a period of twenty years from its organization unless it is sooner dissolved by an act of Congress, or unless its franchise becomes forfeited for some violation of law" (sec. 4).

Acting under the authority of these provisions, the Organization Committee divided the country into twelve Federal reserve districts and designated in each a Federal reserve city. Boston was designated as the Federal reserve city for district No. 1; New

York for district No. 2; Philadelphia for district No. 3; Cleveland for district No. 4; Richmond for district No. 5; Atlanta for district No. 6; Chicago for district No. 7; St. Louis for district No. 8; Minneapolis for district No. 9; Kansas City for district No. 10; Dallas for district No. 11; San Francisco for district No. 12. A certificate to that effect was filed on April 2nd, 1914 in the office of the Comptroller of the Currency.

A Federal reserve bank was duly organized at each of these cities. On May 18–20, 1914, all filed their certificates of organization and thereby became bodies corporate with the rights and powers enumerated in section 4 of the Act. Their organization was officially announced by the Secretary of the Treasury, pursuant to the second paragraph of section 19 of the Act, and on November 14th, 1914, pursuant to section 4 of the Act, they were authorized by the Comptroller of the Currency to commence business.

They have been engaged in business for a little over a year. Their statement for the week ending November 12th, 1915, shows their capital, deposits, and total resources, as follows:

Federal Reserve Bank of—	Capital	Deposits	Resources
Boston	$5,171,000	$22,218,000	$28,615,000
New York	11,059,000	181,710,000	196,544,000
Philadelphia	5,273,000	19,933,000	25,206,000
Cleveland	5,945,000	18,556,000	24,501,000
Richmond	3,352,000	*13,160,000	21,669,000
Atlanta	2,417,000	*11,268,000	16,629,000
Chicago	6,635,000	49,993,000	56,628,000
St. Louis	2,778,000	11,204,000	13,982,000
Minneapolis	2,495,000	10,425,000	12,920,000
Kansas City	3,027,000	9,826,000	14,080,000
Dallas	2,753,000	*11,992,000	18,671,000
San Francisco	3,941,000	14,032,000	17,973,000
Total	54,846,000	374,317,000	446,192,000

*Includes government deposit of $5,000,000.

All of them have issued Federal reserve notes, of which at the present time $160,000,000 in round figures are outstanding.

One has purchased a site for its bank building, and the others have leased quarters for long terms.

The question is: Has the Federal Reserve Board the power to

abolish any of the existing Federal reserve districts established by the Organization Committee as hereinabove described?

As there can be only one Federal reserve bank in a district, a district cannot be abolished without abolishing a bank. Therefore, inseparably linked with the question first stated is the further question: Has the Federal Reserve Board the power to *abolish* a Federal reserve bank?

And since, concededly, the power to *abolish* a Federal reserve district or a Federal reserve bank is not granted in express terms, the question finally becomes: Is it to be implied from other provisions of the Act that Congress intended to confer that power?

The Counsel of the Board held not, in an opinion dated March 1st, 1915. Subsequently, Mr. Joseph P. Cotton, of New York, was consulted, and he reached the opposite conclusion in an opinion dated November 19th, 1915.

The Federal reserve banks are not banks in the ordinary sense. They are banks composed of banks. They touch the business life of the nation in its most sensitive spot. Of all the processes of business, theirs is perhaps the most delicate.

In determining whether Congress intended by implication to confer upon the Federal Reserve Board power to abolish one or more of these institutions, it is proper to consider that if the power exists at all it may be exercised not only now, but at any time in the future. Certainly it was the expectation of Congress that the Federal reserve banks would extend their roots deep; that upon them as a foundation permanent banking arrangements better than any we have ever known would be constructed; and that they would become interwoven with the business fabric of the country.

If these expectations shall be realized, and in this discussion we must assume that they will be, the abolition of one or more of the Federal reserve districts, and consequently of one or more of the Federal reserve banks, whether for better or for worse, would profoundly affect the currents of trade and alter the whole face of business throughout vast sections of the country, to say nothing of the effect upon the investments of member banks and perhaps of the public in the capital stocks of reserve banks.

It must be acknowledged that the power to do such a thing is, to borrow a phrase of the Supreme Court, "a power of supreme

delicacy and importance;" and I am of the opinion that the failure to confer such a power in express terms would be regarded by the courts as virtually conclusive that Congress did not intend it to be exercised except by itself.

A leading case in point is Interstate Commerce Commission *v.* Railway Co. (167 U. S., 479). There the question was whether the Interstate Commerce Commission, when it found a particular rate to be unreasonable, was given the power by the act to regulate commerce as originally enacted to prescribe what should be a reasonable rate for the future. As in the present instance, the power in question was not expressly given, but the commission claimed that it had the power by necessary implication.

Briefly stated, its contention was, that it was expressly charged with the enforcement and execution of the provisions of the act; that amongst other provisions was section 1 which required all charges to be reasonable and just and prohibited every unjust and unreasonable charge; that in the nature of things it could not enforce this mandate of the law without a determination of what are reasonable and just charges; and finally, since no other tribunal was created to make that determination, it must be implied that the commission was authorized to do so (167 U. S., 500, 501).

The court, overruling this contention, held that as the act did not expressly grant the power the commission did not possess it. Speaking through Mr. Justice Brewer, the court said:

"The question debated is whether it (Congress) vested in the commission the power and the duty to fix rates; and the fact that this is a debatable question, and has been most strenuously and earnestly debated, is very persuasive that it did not. The grant of such a power is never to be implied" (494).

Again, it refers to—

"the inference which irresistibly follows from the omission to grant in express terms to the commission this power of fixing rates" (506).

And again—

"The vice of this argument is that it is building up indirectly and by implication a power which is not in terms granted" (509).

Still again—

"And if it (Congress) had intended to grant the power to establish rates, it would have said so in unmistakable terms" (509).

Whilst this seems to me decisive of the matter, I will nevertheless examine the provision of the Act which is put forward as a ground for implying that Congress intended to confer upon the Federal Reserve Board the power in question. That provision, which is found in section 2 immediately following the grant of power to the Organization Committee to designate Federal reserve cities and to establish Federal reserve districts, reads as follows:

"The determination of said Organization Committee shall not be subject to review except by the Federal Reserve Board when organized: *Provided*, That the districts shall be apportioned with due regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States. The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board, not to exceed twelve in all."

The merely negative statement that the determination of the Organization Committee "*shall not* be subject to review except by the Federal Reserve Board when organized" clearly cannot be enlarged into an affirmative grant of power to the Board to review and set aside everything done by the Organization Committee. The reasonable view is that by that language Congress meant that the determination of the Organization Committee should not be subject to review at all, except in so far as the subsequent provisions specifically authorize a review by the Federal Reserve Board. The only subsequent provision authorizing a review of the determination of the Organization Committee of the Federal Reserve Board is contained in the sentence—

"The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board, not to exceed twelve in all."

But the power to *readjust* districts does not necessarily carry with it the power to *abolish* districts and banks. On the contrary, it would be departing from the usual meaning of the language to give it that effect. In the affairs of business especially the word "readjust" is associated with the idea of preservation rather than of destruction. When it is used in connection with any business or political entity we instinctively think not of the destruction of that entity but of its preservation in some other form. When it is

used in connection with a geographical area, such as a district, we instinctively think of changes in boundary lines, not of the blotting out of anything. To illustrate, suppose the Constitution had provided that Congress should have power to *readjust* the States taken into the Union. Would it be contended that this included power to abolish States? I cannot think so. Likewise here, in my opinion, the power to readjust districts refers to changes in boundary lines.

This conception of the power is exemplified in the changes heretofore made by the Federal Reserve Board in the boundaries of the districts as fixed by the Organization Committee. To cite one instance, northern New Jersey was detached from the district of which Philadelphia is the center and annexed to the district of which New York is the center.

But if what was meant by readjustment of districts were obscure instead of reasonably clear, there would still be no ground for implying the power to abolish districts and consequently to abolish banks from a power to readjust districts and to add new districts.

A power not expressly conferred can arise as an incident to the exercise of some other power only because essential to the exercise of that power or because included therein as a *lesser* power of like nature or effect. (The Floyd Acceptance, 7 Wall., 666, 680; Branch *v.* Jessup, 106 U. S., 468, 478.)

No one would say that the power to *abolish* is a lesser power than the power to readjust. It only remains then to inquire whether the power to *abolish districts and banks* is essential to the exercise of the power to *readjust districts*. In other words, would the power to *readjust districts*, which is expressly conferred upon the Board, be nullified or rendered impotent if the power to *abolish districts and banks* is withheld?

I have not heard that contention made and do not see how it could be made. Obviously the power conferred can fall short of the power of abolition and still have a wide and useful field of operations. From time to time much may be done to promote the convenience and efficiency of the System by readjusting the boundaries of districts, adding here and taking away there, without abolishing districts and without abolishing banks.

The only grounds upon which a power may be implied are thus

lacking here. Rather the specification of the power to readjust districts and of the power to increase the number of districts carries with it the implication that Congress did not intend to grant the greater power to abolish districts. As the Supreme Court has said in similar circumstances:

". . . If Congress had desired to grant such authority it would have been easy to have said so in express terms." (Tillson *v.* United States, 100 U. S., 43, 46.)

Again it does not seem reasonable to suppose that Congress would have authorized the Organization Committee to establish these very elaborate banking units if another body to be organized only a few months later was to have the power not only to make readjustments among them but to abolish altogether a substantial number of them.

Finally, the power of readjusting districts and of creating new districts conferred by this provision upon the Federal Reserve Board is subject to two limitations only: (1) There must be "due regard to the convenience and customary course of business," and (2) the number of districts cannot exceed twelve (sec. 2). If, therefore, the power to readjust districts includes the power to abolish districts, I see nothing to prevent the Board from abolishing districts and banks until the number is reduced not only to eight but to six, four, or even one, if in the judgment of the Board "due regard to the convenience and customary course of business" dictates that policy. Assuredly Congress intended no such result.

But not only does *this* provision afford no sufficient basis for implying that Congress intended to grant the power in question; there is *another* provision in the Act which shows affirmatively, I think, that it *did not* intend to grant that power.

Section 4 provides that—

"Upon the filing of such certificate with the Comptroller of the Currency as aforesaid, the said Federal reserve bank shall become a body corporate and as such, and in the name designated in such organization certificate, shall have power. . . .

"Second. *To have succession for a period of twenty years from its organization unless it is sooner dissolved by an act of Congress, or unless its franchise becomes forfeited by some violation of the law.*"

Here is an assurance by Congress that a Federal reserve bank

organized under the provisions of this Act shall have the right to exist for a period of twenty years, except in two specific contingencies, i.e., unless it shall forfeit the right by a violation of law, or unless Congress itself shall shorten the period.

The Federal reserve banks were organized, their capital subscribed, and large obligations undertaken by them on the faith of that express assurance and in the expectation of enjoying that right.

Manifestly, to imply a power in the Federal Reserve Board to abolish Federal reserve banks at will would directly conflict with the rights and powers expressly conferred upon those banks by this section.

A power thus *expressly* conferred cannot be destroyed or seriously impaired by *implying* a conflicting power—at least not unless the grounds for the implication are irresistible, which, as we have seen, is not the case here. (Texas & Pacific Ry. Co. *v.* Abilene Cotton Oil Co., 204 U. S., 426, 440, 441, 446; Wilder Mfg. Co. *v.* Corn Products Co., 236 U. S., 165, 174, 175.)

Finally, it remains to be observed that the reports of the committees which considered this Act and the debates attending its passage, while discussing fully many different powers conferred or proposed to be conferred upon the Federal Reserve Board, contain no mention of the power here in question. This is very significant. It shows, I think, an entire absence on the part of Congress of any thought of conferring such a power. For, considering the far-reaching consequence of the power, it is not easy to believe that if the granting of it had been under consideration at all, the fact would not have been mentioned by some one in the course of the thorough and exhaustive discussion which the subject underwent in Congress.

I sum up my conclusions as follows:

First, concededly the power to abolish Federal reserve districts and Federal reserve banks is not conferred upon the Federal Reserve Board in express terms; second, it is a rule of statutory construction that the failure to grant in express terms a power of such great consequence raises a convincing presumption that Congress did not intend to grant it; third, putting out of view that presumption, there is no provision in the Act from which an inten-

tion to confer this power can fairly be implied, but on the contrary, there is a provision which shows affirmatively that Congress did not intend to confer it; fourth, the absence of any mention of such a power in the reports of committees and the debates dealing with the legislation shows that the thought of conferring it was not in the mind of Congress. I am of the opinion, therefore, that the Board does not possess the power in question.

Very respectfully,
T. W. Gregory
Attorney General

The President,
The White House

APPENDIX THIRTY-ONE

OPINION OF T. W. GREGORY, ATTORNEY GENERAL, CONCERNING THE RIGHT OF THE FEDERAL RESERVE BOARD TO CHANGE THE PRESENT LOCATION OF ANY FEDERAL RESERVE BANK, APRIL 14, 1916[1]

DEPARTMENT OF JUSTICE

Washington, April 14th, 1916

SIR:

At the request of the Federal Reserve Board, you have submitted the following questions for my opinion:

1. Can the Federal Reserve Board legally change the present location of any Federal reserve bank:

(*a*) In the case where there has been no alteration in the district lines, and

(*b*) In the case where there has been such readjustment of district lines as in the opinion of the Board necessitates the designation of a new Federal reserve city in order that due regard may be given to the convenience and customary course of business as required by section 2 of the Federal Reserve Act?

2. Must the Federal Reserve Board, in exercising its admitted power to readjust, preserve the $4,000,000 minimum capitalization required of each Federal reserve bank as a condition precedent to the commencement of business?

I

In my opinion of November 22nd, 1915, I expressed the view that the Federal Reserve Act does not confer on the Federal Reserve Board the power to abolish any of the existing Federal reserve banks or Federal reserve districts. I believe that the reasoning of that opinion is equally applicable to both branches of the first question now submitted.

[1] *Federal Reserve Bulletin*, Vol. 2.

Section 2 of the Federal Reserve Act provides:

"As soon as practicable, the Federal Reserve Bank Organization Committee shall designate not less than eight nor more than twelve cities to be known as Federal reserve cities, and shall divide the continental United States . . . into districts, each district to contain only one of such Federal reserve cities. The determination of said Organization Committee shall not be subject to review except by the Federal Reserve Board when organized:

Provided, That the districts shall be apportioned with due regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States. The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board, not to exceed twelve in all. Such districts shall be known as Federal reserve districts and may be designated by number. . . .

"Said Organization Committee shall be authorized . . . to make such investigation as may be deemed necessary by the said committee in determining the reserve districts and in designating the cities within such districts where such Federal reserve banks shall be severally located."

The same section further provides:

"The said committee shall supervise the organization, in each of the cities designated, of a Federal reserve bank, which shall include in its title the name of the city in which it is situated, as 'Federal Reserve Bank of Chicago'."

Since the Act thus provides that each city designated as a Federal reserve city is to be the location of a Federal reserve bank it follows that a change in the location of a Federal reserve bank would in effect be the designation of a new Federal reserve city and the abandonment of one previously designated. I find no more warrant in the Act for the abandonment of one Federal reserve city and the designation of a new one than I do for the abolition of a Federal reserve district when once established.

The power to designate a new Federal reserve city (twelve cities having been named by the Organization Committee) or to change the location of a Federal reserve bank is not expressly conferred by the Act on the Federal Reserve Board. If the Board possesses such power, it is only by implication from the provision that—

"The determination of said Organization Committee shall not be subject to review except by the Federal Reserve Board when organized:

Provided, That the districts shall be apportioned with due regard to the convenience and customary course of business and shall not necessarily be coterminous with any State or States. The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board, not to exceed twelve in all."

In my opinion there is no clear indication, either in the provision just quoted or elsewhere in the Act, of an intent to confer on the Federal Reserve Board the power to change the location of Federal reserve banks by the designation of new Federal reserve cities. On the contrary, there are indications of an opposite intent. As stated in my opinion of November 22nd, 1915, above referred to, "the merely negative statement that the determination of the Organization Committee shall not be subject to review except by the Federal Reserve Board when organized clearly cannot be enlarged into an affirmative grant of power to the Board to review and set aside everything done by the Organization Committee. The reasonable view is that by that language Congress meant that the determination of the Organization Committee should not be subject to review at all, except in so far as the subsequent provisions specifically authorize a review by the Federal Reserve Board. The only subsequent provision authorizing a review of the determination of the Organization Committee by the Federal Reserve Board is contained in the sentence, 'The districts thus created may be readjusted and new districts may from time to time be created by the Federal Reserve Board, not to exceed twelve in all'."

Again, as stated in that opinion, "a reading of the Act shows at once that the Organization Committee was created not merely for the purpose of attending to the formalities of organization or to serve as a stop-gap until the Federal Reserve Board should come into existence, but that it had an independent function to perform and to that end was invested with wide powers. That is to say, its function was to organize the System as contradistinguished from the function of the Federal Reserve Board, which was primarily to administer the System."

The duty of designating Federal reserve cities belonged to the Reserve Bank Organization Committee as a part of the organization of the System, and the committee was required by the Act to designate not less than eight nor more than twelve cities. This duty is named first among those imposed upon the Organization Committee, and it is imposed by the same provision of section 2 which required the committee to divide the United States into Federal reserve districts. The same considerations that indicate an intention that the several districts should be permanent would also indicate that the designation of the cities was not to be made for temporary purposes, but was intended to be permanent, subject, of course, to change by Congress. The designation was to be made only after thorough investigation, and the same machinery was provided to facilitate both the determination of the districts and the designation of the cities. Thus, section 2 provides:

"Said Organization Committee shall be authorized to employ counsel and expert aid, to take testimony, . . . and to make such investigation as may be deemed necessary . . . in determining the reserve districts and in designating the cities within such districts where such Federal reserve banks shall be severally located."

In my opinion, this coupling of the duty of determining the districts with the duty of designating the Federal reserve cities within the several districts shows an intention on the part of Congress that the cities so designated are to constitute the fixed centers in the scheme or system of division, the duty of designating the cities being coördinate with the duty of forming districts around them. It was left to the discretion of the Organization Committee whether it should designate the full number of Federal reserve cities and establish the full number of Federal reserve districts permitted by the Act. The committee elected to designate and establish the full number authorized, thereby practically suspending the operation of the provision of the Act that "new districts may from time to time be created by the Federal Reserve Board not to exceed twelve in all." The primary if not the only purpose of that provision must have been to take care of the situation in the event that the Organization Committee had designated less than twelve Federal reserve cities.

The fact that the Federal Reserve Board, aside from the provi-

sion relating to the creation of new districts from time to time, was merely given the power to readjust districts suggests that there was to be some permanent characteristic or element in the districts created by the Organization Committee. If, however, in addition to the power which the Federal Reserve Board has of readjusting districts by changing their boundary lines, it also possessed the power to change the location of the respective Federal reserve cities within such districts, then the Board could, by successive changes of cities and boundaries, entirely obliterate existing districts and substitute in their place new districts totally different from those created by the Organization Committee. I do not think that Congress intended to confer such a power.

The Act provides that each Federal reserve bank is to include the name of the city in which the bank is located. By section 4 it is provided that the organization certificate of each bank shall state specifically—

"The name of such Federal reserve bank, the territorial extent of the district over which the operations of such Federal reserve bank are to be carried on, the city and State in which said bank is to be located, the amount of capital stock, and the number of shares into which the same is divided. . . . "

Upon the filing of such certificate with the Comptroller of the Currency in the manner prescribed such Federal reserve bank—

"Shall become a body corporate and as such, and in the name designated in such organization certificate, shall have power . . . to have succession for a period of twenty years from its organization unless it is sooner dissolved by an act of Congress, or unless its franchise becomes forfeited by some violation of law." (Sec. 4.)

It is to be noted that there is no provision in the Act by which the Federal Reserve Board may change the name of a Federal reserve bank or amend its certificate in this respect. The whole tenor suggests permanency.

The omission of Congress to grant by express language the power to change Federal reserve cities is significant, especially in view of the language of section 11 (e) of the Act, which confers the power—

"To add to the number of cities classified as reserve and central

reserve cities . . . ; or to reclassify existing reserve and central reserve cities, or to terminate their designation as such."

It would have been equally easy had Congress desired to grant the authority to designate new Federal reserve cities to have said so in express terms. (Tillson *v.* United States, 100 U. S., 43, 46, quoted in my opinion of Nov. 22nd, 1915, supra.)

It may be suggested that changes in the "customary course of business" or other changes not foreseen by the Organization Committee may result in inconveniences which the Federal Reserve Board cannot remedy if its power to change the location of Federal reserve cities is denied. The answer is that the remedy is with Congress, in so far as it may not already be supplied by section 3, which authorizes the establishment of as many branch banks in any district as may be found expedient.

To sum up my conclusion on the question of whether the Federal Reserve Board can legally change the present location of any Federal reserve bank, I am of opinion that the Board has no such power, and that such power is lacking whether there has been an alteration or readjustment in the district lines or not.

II

Coming now to the consideration of the second question submitted, namely, whether the Federal Reserve Board, in exercising its admitted power to readjust, must preserve the $4,000,000 minimum capitalization required of each Federal reserve bank as a condition precedent to the commencement of business, I am of opinion that this question is to be answered in the negative.

The Federal Reserve Act provides in section 2:

"No Federal reserve bank shall commence business with a subscribed capital less than $4,000,000."

The same section also contains a provision requiring subscriptions to the capital stock to be paid—

"One-sixth . . . on call of the Organization Committee or of the Federal Reserve Board, one-sixth within three months and one-sixth within six months thereafter, and the remainder of the subscription, or any part thereof, shall be subject to call when deemed necessary by the Federal Reserve Board . . . ."

Section 4 contains the following provision:

"When the minimum amount of capital stock prescribed by this Act for the organization of any Federal reserve bank shall have been subscribed and allotted, the Organization Committee shall designate any five banks . . . to execute a certificate of organization. . . .

"Upon the filing of such certificate with the Comptroller of the Currency, the said Federal reserve bank shall become a body corporate."

The decrease of capital stock is authorized by the following provision of section 5:

"The outstanding capital stock shall be increased from time to time as member banks increase their capital stock and surplus, or as additional banks become members, and may be decreased as member banks reduce their capital stock or surplus or cease to be members."

Additional provisions relating to the decrease of capital stock are found in sections 5 and 6, as follows:

"Sec. 5. . . . When a member bank reduces its capital stock it shall surrender a proportionate amount of its holdings in the capital of said Federal reserve bank, and when a member bank voluntarily liquidates, it shall surrender all of its holdings of the capital stock of said Federal reserve bank and be released from its stock subscription not previously called. In either case the shares surrendered shall be canceled and the member bank shall receive in payment therefor . . . a sum equal to its cash-paid subscriptions on the shares surrendered . . . less any liability of such member bank to the Federal reserve bank.

"Sec. 6. If any member bank shall be declared insolvent . . . the stock held by it in said Federal reserve bank shall be canceled . . . and all cash-paid subscriptions on said stock, with one-half of one per cent per month from the period of last dividend, not to exceed the book value thereof, shall be first applied to all debts of the insolvent member bank to the Federal reserve bank, and the balance, if any, shall be paid to the receiver of the insolvent bank. Whenever the capital stock of a Federal reserve bank is reduced, either on account of a reduction in capital stock of any member bank or of the liquidation or insolvency of such bank, the

board of directors shall cause to be executed a certificate to the Comptroller of the Currency showing such reduction of capital stock and the amount repaid to such bank."

In section 9 it is provided:

"If at any time . . . a member bank has failed to comply with . . . the regulations of the Federal Reserve Board, it shall be within the power of the said Board, after hearing, to require such bank to surrender its stock in the Federal reserve bank; . . . and said Federal reserve bank shall, upon notice from the Federal Reserve Board, be required to suspend said bank from further privileges of membership, and shall within thirty days of such notice cancel and retire its stock and make payment therefor in the manner herein provided."

It will be observed from the foregoing quotations that the Federal Reserve Act expressly provides that no Federal reserve bank shall commence business with a subscribed capital of less than $4,000,000. (Sec. 2.) They were each to be organized when the minimum amount of capital stock had been subscribed. (Sec. 4.) Only three-sixths of the capital subscribed is required to be paid in, the remainder being left "subject to call when deemed necessary by the Federal Reserve Board." (Sec. 2.)

The Act specifically provides for the decrease of capital stock (1) as member banks reduce their capital stock; and (2) as they cease to be members. (Sec. 5.)

Member banks may cease to be members for any of four causes:

(*a*) Voluntary liquidation (sec. 5);

(*b*) Insolvency (sec. 6);

(*c*) Violation of regulations of Federal Reserve Board (sec. 9);

(*d*) Transfer from one Federal district to another through readjustment of districts (sec. 2).

The Act specifically requires the cancellation of capital stock where membership ceases under (*a*), (*b*), or (*c*). (Secs. 5, 6, and 9.)

No specific provision is made for cancellation of capital stock where membership ceases under (*d*).

While the minimum capital had to be subscribed in order to commence business, the maintenance of that minimum is nowhere prescribed by the Act. The fact that the Board is to determine whether more than half the subscription is to be paid in seems to

indicate that the minimum to be subscribed was fixed as a precaution to make sure that ample credit should be pledged to insure the success of the System.

Not only is the maintenance of the minimum not prescribed, but express provision is made for reducing the capital stock as, or whenever, member banks cease to be members. This language is general and includes in its terms all cases in which member banks cease to be members. It is coupled with no expressed condition that the minimum capitalization be preserved; and since the Federal Reserve Act required the organization of the Federal reserve banks upon the subscription of the minimum, it is obvious that any reduction whatever made after commencing business might reduce the capital below the minimum.

It is plain that a member bank can be a member only of the Federal reserve bank of the district in which both are located. This is obvious from the nature of the Federal reserve districts and is assumed in sections 2, 4, and 9.

Of necessity, therefore, when the Federal Reserve Board, in the exercise of its power to readjust, transfers a member bank from one district to another, such transferred bank must cease to be a member of the Federal reserve bank of the district from which it is transferred. When it thus ceases to be a member, the capital of the Federal reserve bank may be reduced; and there is nothing in the Act requiring the reduction to be made subject to the maintenance of a minimum capital.

It is to be noted that section 5 provides that the capital stock *shall* be increased and *may* be decreased under the conditions therein mentioned. Succeeding provisions of sections 5, 6, and 9, however, make it clear that *may* is here used in the sense of *shall*, as applied to cases arising under (*a*), (*b*), and (*c*). It seems reasonable to infer that it is used in the same sense as applied to (*d*). But whether so used or used in its more literal sense is here immaterial, for so far as the answer to the question submitted is concerned, the result is the same whether the Board is *required* or merely *authorized* to reduce the capital when member banks cease to be members.

Nor can any significance be attached to the fact that specific provision is made for reducing the capital stock of a Federal

reserve bank in cases arising under (*a*), (*b*), and (*c*), while the Act is silent as to cases arising under (*d*). The cases specifically provided for include cases where the member banks cease to be members as the direct result of their own acts or conduct. Cases under (*d*) arise where banks cease to be members as an incident of the exercise of the power of the Federal Reserve Board to readjust districts. The grant of the specific power to readjust carries with it, as fully as if expressed in the Act, the power to do what is necessarily incidental. (Broom's Maxims, 7th ed., 505; 199 U. S., 12.)

My conclusion as to the second question submitted is that the Federal Reserve Act, in prescribing a minimum capitalization of $4,000,000 for Federal reserve banks as a condition precedent to commencing business, does not require that such minimum capitalization shall be preserved under the circumstances.

Very respectfully,
T. W. Gregory
Attorney General

The President,
The White House

APPENDIX THIRTY-TWO

LETTER TO PRESIDENT WILSON

Washington, May 27th, 1918

DEAR MR. PRESIDENT:

On August ninth my four-year term of office as a member of the Federal Reserve Board will expire. I do not know whether or not, under the constant burden of grave and pressing decisions, you have reached the point where you wish to deal with the question of naming my successor, or whether or not you contemplate to have me continue in this work. Nor would I presume to broach this question were it not that I felt that, in consequence of recent occurrences, it has become one of policy rather than of personalities.

Certain persons have started an agitation to the effect that a naturalized citizen of German birth, having near relatives prominent in German public life, should not be permitted to hold a position of great trust in the service of the United States. (I have two brothers in Germany who are bankers. They naturally now serve their country to the utmost of their ability, as I serve mine.)

I believe that the number of men who urge this point of view is small at this time. They probably have not a proper appreciation of the sanctity of the oath of allegiance or of the oath of office. As for myself, I did not take them lightly. I waited ten years before determining upon my action, and I did not swear that "I absolutely and entirely renounce and abjure all allegiance and fidelity to any foreign potentate, and particularly to Wilhelm II, Emperor of Germany," etc. until I was quite certain that I was willing and anxious to cast my lot unqualifiedly and without reserve with the country of my adoption and to defend its aims and its ideals.

These are sad times. For all of us they bring sad duties, doubly hard, indeed, for men of my extraction. But, though, as in the Civil War, brother must fight brother, each must follow the

straight path of duty, and in this spirit I have endeavored to serve during the four years that it has been my privilege to be a member of the Federal Reserve Board.

I have no doubt that all fair-minded and reasonable men would consider it nothing short of a national disgrace if this country, of all countries, should condone or endorse the attitude of those who would permit the American of German birth to give his all, but would not trust him as unreservedly and as wholeheartedly as he, for his part, serves the country of his adoption. Unfortunately, however, in times of war, we may not always count upon fair reasoning. It is only too natural that, as our casualty lists grow, bitterness and undiscriminating suspicion will assert themselves in the hearts of increasing numbers—even though these lists will continue to show their full proportion of German names.

Much to my regret, Mr. President, it has become increasingly evident that should you choose to renominate me this might precipitate a harmful fight which, in the interest of the country, I wish to do anything in my power to avoid and which, even though resulting in my confirmation, would be likely to leave an element of irritation in the minds of many whose anxieties and sufferings may justify their intense feelings. On the other hand, if for reasons of your own, you should decide not to renominate me it is likely to be construed by many as an acceptance by you of a point of view which I am certain you would not wish to sanction. In these circumstances, I deem it my duty to state to you myself that it is my firm belief that the interest of the country will best be served if my name be not considered by you in this connection.

I am frank to admit that I have reached this conclusion with the deepest regret both on account of its cause and its effect. I have considered it the greatest privilege to serve my country at this time, and I do not abandon lightly a work, half done, in which I am deeply and genuinely interested. But my continuation in office under present conditions might make the Board a target of constant attack by unscrupulous or unreasoning people, and my concern to save any embarrassment to you and to the Board in the accomplishment of its work would make it difficult for me to conserve that independence of mind and freedom of action without which nobody can do justice to himself or his office.

In writing you this letter, I have been prompted solely by my sincere conviction that the national welfare must be our only concern. Whatever you may decide to be best for the country will determine my future course. We are at war, and I remain at your orders.

May your patience and courage be rewarded and may it be given to you to lead our country to victory and peace!

Respectfully and faithfully yours,

PAUL M. WARBURG

The President,
The White House,
Washington, D. C.

APPENDIX THIRTY-THREE

LETTER FROM PRESIDENT WILSON

August 9th, 1918

My Dear Mr. Warburg:

I hope that my delay in replying to your letter concerning your retirement from the Federal Reserve Board has not given you an impression of indifference on my part or any lack of appreciation of the fine personal and patriotic feeling which made that letter one of the most admirable and gratifying I have received during these troubled times. I have delayed only because I was hoping that the Secretary of the Treasury would be here to join me in expressing the confidence we both feel, alike in your great ability and in your unselfish devotion to the public interest.

Your retirement from the Board is a serious loss to the public service. I consent to it only because I read between the lines of your generous letter that you will yourself feel more at ease if you are free to serve in other ways.

I know that your colleagues on the Board have not only enjoyed their association with you, but have also felt that your counsel has been indispensable in these first formative years of the new system which has served at the most critical period of the nation's financial history to steady and assure every financial process, and that their regret is as great as my own that it is in your judgment best now for you to turn to other methods of service. You carry with you in your retirement from this work to which you have added distinction, my dear Mr. Warburg, my sincere friendship, admiration, and confidence, and I need not add, my cordial good wishes.

Cordially and sincerely yours,

Woodrow Wilson

Hon. Paul M. Warburg,
Federal Reserve Board

APPENDIX THIRTY-FOUR

MEMORANDUM TO THE FEDERAL RESERVE BOARD WARNING AGAINST FORCING FEDERAL RESERVE BANKS TO INVEST AND URGING THE USE OF BANKERS' ACCEPTANCES TO FINANCE TRADE BETWEEN FOREIGN COUNTRIES MARCH 30, 1915

We take many things for granted and consider them axiomatic without stopping to consider why. That easy money rates create expansion and that expansion ultimately brings about a reaction accompanied by high money rates, is a doctrine in point. What, however, is the theory underlying this process?

If a country bank has a capital of $20,000 and invests $80,000 of its resources at 5 per cent, it earns $4,000 gross. (Though this equals 20 per cent gross and appears a large return, it may not be excessive if we consider that from this $4,000 there must be paid salaries, rent, etc.) If credit is worth only 2 per cent, this bank will have to invest $200,000 at 2 per cent in order to earn $4,000; and those who cannot put out a larger volume of loans will take chances in making poorer investments, from which liberal returns can always be obtained. In other words, the lower the rate, the stronger the temptation for the banks to act without due caution. The greater the desire of the bank to put out its money, the easier it will be for the borrower to secure overgenerous credit facilities, which in turn will lead him to expansion. He may thus be induced to put borrowed money into plant and machinery or into large supplies of goods. When general apprehension of overexpansion is awakened, or when some additional seasonal or extraordinary demands occur—often demands directly caused by the artificially increased activity—all simultaneously realize that the limit of credit expansion has been reached. A dearth of credit, accompanied by violent contraction and extreme interest rates are the consequences then sure to follow.

It should be the duty of all banks to recognize this sequence of conditions and to govern their conduct accordingly. The large and conservative banks, on which the brunt of the burden falls in case of a general collapse, are fully aware of the danger and try to remain conservative. Nevertheless, in the long run, the spirit of selfishness and competition makes itself felt, and the old adage that "John Bull can stand anything, but he cannot stand 2 per cent" holds good in every country. Against this dangerous tendency to expand the strongest element of protection is found, when wisely managed, in the large central note-issuing banks. They fulfill their duty of preventing overexpansion by working in time for harder money rates. Either by refusing to do new business they gradually liquidate their holdings of paper or they sell treasury bills or other securities, accumulating cash against them or, as is frequently done by the Bank of England, they even borrow in the open market.

Have we in the United States at present conditions that are pregnant with the dangers following great ease of money? With hundreds of millions suddenly released and a future highly uncertain, I believe there can be no doubt as to what the conclusions of the Board will be on this point In order to gain a clear basis for future discussions concerning the policy to be adopted and the best ways and means of carrying it into effect, it is however important that a definite understanding be reached.

Some members of the Board still urge a policy of lower rates; others feel that while it was incumbent on the Board to aid in making money easier, when conditions prevailed such as were originally met, it is now a clear duty not to aggravate the existing plethora of money, but rather to ward off the evil effects certain to follow an overabundance of credit.

It is my suggestion that a vote be taken on this question and a clear-cut policy agreed upon. Unless this be done, it is impossible to adopt the measures which must be taken from time to time without engaging in endless and fruitless discussions. There must be an understanding on theory and policy before we can pass upon the means of attaining the aims agreed upon.

If, as I suppose to be the case, a majority of the Board does not

wish to increase the ease of money at this time, then we must accept these further conclusions:

First. When normal rates fail to bring business to the Federal reserve banks we must not try by underbidding to force our funds into the investments sought by the commercial banks. As it has been tried to show above, we should otherwise take the responsibility of forcing upon them a policy of either underbidding us or of going into fields of greater hazard. Into these we should be the last to drive them.

Are we then to sit still and not earn our expenses and dividends? What, in that case, would the people say? What will they say if, ultimately, by being short-sighted now, we ourselves should bring about a stringency—the very condition which we are justly expected to guard against? Would it not be better to have the people better informed of our duties and policies? It will not take long to gain the sympathy of those who are most interested in our earnings, the member banks. As a matter of fact, presidents of banks, large and small, north and south, have informed us that they would not be the least disappointed to have the Federal reserve banks fail to earn their dividends under present circumstances, that they would be amply repaid, even if they received no return on their investment at all, if our system provided safety. They have expressed the hope that we should remain cool and conservative and should not permit ambition for earnings and quick results to tempt the Federal reserve banks from the wise path of conservatism. I must confess to a feeling of humiliation that our members should have found it necessary to express these feelings to me when such admonition should more properly come from the Federal Reserve Board to them.

Second. We must reach then a conclusion as to the next question: Is the policy of this Board to be framed according to misconceptions and prejudices prevalent among "the people," or is it the duty of the Board to educate the people to a better understanding of the broad questions touching finance in general and the problems of the Federal Reserve System in particular? It might be advisable to take a vote also on this question.

Third. While we have seen what investments we must avoid at the present time, we must on the other hand, consider the posi-

tive side of the program of what we may and must do. Before doing that, however, we shall have to undertake one more process of elimination.

If we were not confronted with entirely abnormal circumstances caused by the European War, present conditions would lead Federal reserve banks to a policy of investing heavily in foreign bills. Foreign exchange rates are remarkably low and would, therefore, favor such a venture. In addition, by investing in foreign bills, we should withdraw our funds from the home market and thereby exercise an influence in the direction of hardening money rates. We should invest our funds temporarily so as to bring some return from foreign countries. As we should buy only short paper, this would place us in a position, at any time when we should again want our funds for use in our own country, to rediscount the foreign paper thus acquired or to collect it as it matures and to sell foreign exchange against these funds as they became available at probably profitable prices. We should use foreign countries, therefore, as a means of steadying our own money rates and should keep these foreign countries as reservoirs to be drawn upon at our will.

Unfortunately, there are very serious objections to our going into that field of operation at this time. As long as the War continues, the holding of paper in foreign currencies involves the danger of laying ourselves open to any measures that may be taken for their own protection by those foreign countries.

It cannot be foreseen whether this protection will take the form of renewed moratoria or of a refusal to ship gold or of increased prices to be paid for gold by the government banks. It is therefore impossible to foretell with any degree of safety whether a purchase of foreign exchange at this time would be likely to lead to a profit or to a loss. Moreover, the Federal reserve banks might subject themselves to severe criticism if they found their funds "tied up" in foreign countries when they wanted to withdraw them, or if they should incur losses in foreign countries, such as might result from critical financial conditions likely to prove to be the consequence of the present turmoil.

Confidential inquiries have elicited the general reply that Federal reserve banks would be disinclined at this time to go

into foreign exchange transactions or to open the foreign accounts which would be necessitated by such transactions.

It has been suggested that the Federal reserve banks do what the Bank of England would be apt to do under present circumstances; that is to say, borrow money. Such a plan might be carried out by an agreement on the part of the Federal reserve banks to pay interest—let us say 2 per cent—on balances of member banks kept in excess of the minimum requirements. Mr. Delano has written a very interesting paper elaborating this thought.

Larger balances thus to be gained by the Federal reserve banks would no doubt constitute an important element of protection in dealing with the question of check clearings. It would also remove the opposition of a great many country banks which now object to increasing their balances with Federal reserve banks without, on the other hand, receiving on these larger balances the interest they now receive from their reserve correspondents. It is clear that in central reserve cities and even to a larger extent in reserve cities, strong objections would be offered against such a plan which, it might be claimed, would tend to bring about within six months what the law advisedly intended to bring about within two and a half years. Moreover, there is a danger that where once the Federal Reserve System begins to pay interest on balances, great pressure will be brought so to amend the law as to force the Federal reserve banks to continue doing so. As a broad principle it is unsound to pay interest on reserve money. Interest on reserve money is in itself a stimulus to the employment of reserve money. If, on the other hand, it should not be employed, the Federal reserve banks would incur a loss which would curtail the income to be received by the government, and would, therefore, be a constant opportunity for political attack and interference. While such a policy of paying interest on borrowed money could, with entire propriety, be adopted as an extraordinary measure in time of dangerous ease of money (which normally would drive gold from the country—a question which it would lead us too far to elaborate here), it would be unsound to adopt such a policy permanently. It is, therefore, not believed that the Board would, or that, indeed, it should, embark upon a policy of paying interest

on excess balances, tempting though this proposal may be in some respects.

Fourth. There remains, however, one large and new field of enterprise heretofore unoccupied by American banking: the bank acceptance, an investment in every respect desirable for the Federal reserve banks. The American bank acceptance, drawn against the importation or exportation of goods, implies, indeed, at present in most cases, competition not with American, but with foreign banks. Heretofore these transactions have been financed by foreign banks and they have received the commissions for accepting, while the discount markets of such foreign countries have carried the acceptances until they matured. In other words, advances against goods in transit from one country to another were carried by foreign countries. In purchasing these acceptances, Federal reserve banks are, therefore, not using reserve money to compete with domestic banks in domestic credits or domestic investments but, on the contrary, American money is loaned to take the place of foreign money. Moreover, while the rate of these bank acceptances is low, the business man who secures the credit in order to carry his goods, pays a commission to the accepting bank, plus the discount rate at which he sells the acceptance. A rate of ¼ per cent to ½ per cent for three months, is equal to 1 per cent to 2 per cent per annum. Adding to that a discount of from 2½ per cent to 3 per cent brings the rate at which he secures his money up to between 4 per cent to 5 per cent. There is, therefore, no overstimulation so far as the business man is concerned. Moreover, if properly restricted, acceptances should be given only for goods actually sold. The acceptance, therefore, in this case is only a helpful instrument in liquidating a closed transaction which matures and ends at a definite time. It is consequently free of the criticism that it stimulates business expansion as might the ordinary credit granted for the general purposes of business.

Fifth. If American banks would give their acceptances (as our counsel advises us they could) to finance shipments from one foreign country to another, the purchase of such acceptances would, under present conditions, be the ideal investment for Federal reserve banks. A transaction of that kind may properly

be considered a foreign investment free of the risks of foreign exchange operations. Instead of drawing on London, the Argentine shipper would draw on New York against goods which he had shipped to London. When the bill matures, he must remit to the United States, and if he cannot find bills of exchange on New York to cover the transaction, it is his duty to find gold. He is by contract bound to secure such gold just as, in the fall of 1914, American houses were obliged to send gold to cover their maturing obligations in London, irrespective of whether or not gold payments had been suspended by the American banks. Investments in acceptances of this kind would permit the Federal reserve banks to secure a return from some part of their idle money without increasing the ease of money here. Such investments would, indeed, be the best reserve investments because if, within the next ninety days, conditions should change here so as to make it desirable to strengthen our own reserves by putting up the bank acceptance rate, we could force the shipper or the importer to cover his indebtedness, meeting the acceptance and using for his new shipments credits in countries which are willing to offer him lower discount rates. If we put out our money in the United States by investing in so-called American commercial paper, our investment is endowed with very much less of the reserve quality because if the money has gone into investments or plants, we can collect our maturing paper only by forcing the commercial banks of the country to take it over from us. We are only shifting the investment from one American pocket into the other, while if at this time we should finance foreign shipments with our bank acceptance, the liquidation of these acceptances would mean that we should be drawing on the surplus of other countries to strengthen our own. It is this feature of the bank acceptance market which cannot be sufficiently emphasized. It possesses an element of elasticity both on account of international relations and on account of the fact that these acceptances can be collected without considering the convenience of the acceptor. This renders the acceptance market the most desirable field of investment for all banks. The larger this market grows and the wider a public it reaches, the safer it becomes and the more readily will the ultimate aim be

achieved of making the acceptance market take the place of the stock-exchange call money market.

The Federal Reserve System will not be a really safe and efficient organization until the acceptance market is thoroughly developed. It can already be seen that, in the acceptance market, the Federal reserve banks will be a controlling factor and, when once sufficiently firmly established, their discount rates for bank acceptances will become not only barometers but, through this agency, important governors of the money market. It must be borne in mind that the safety of note-issuing banks lies in their ability actually to collect bills owned and thereby actually to influence money rates.

Our rates for commercial paper will naturally have to remain fairly high because these rates must be granted in every district to the smallest country banks in remote corners, where rates are naturally comparatively high. The rediscounting of the long-maturity commercial paper will, therefore, be largely restricted to the smaller and weaker banks, and will, therefore, have little direct bearing upon the larger banks whose transactions with their Federal reserve banks will probably generally be based on short-time paper bearing a lower rate. The most effective money rates will, therefore, be the short-term rate and the bank-acceptance rate, particularly when, as it is hoped will ultimately be the case, the acceptance covers domestic transactions as well.

It is the bank acceptance that will bring about real fluidity of credit and will serve as an equalizer of money rates all over the country; for the acceptance of a good bank in New Orleans will sell substantially at the same discount rate as the acceptance of a bank in New York, no matter whether the local rate for commercial paper in one district be five and in the other four per cent. If country banks, instead of keeping call money loaned on the stock exchange, are to hold bank acceptances as part of their working reserve, the market for bank acceptances must be wide and reliable, and the more it is internationalized, the more the foreign banks begin to buy our acceptances, and the more we accept in foreign trade, the stronger this market will be and the more perfectly will it act as a safety valve should we find it necessary to increase our rate. By accepting for foreign countries, we should be creating a gold reserve which can be quickly marshaled so as to enable

us to respond to the commercial demands of the country. At the same time, this reserve would act as a buffer in case exchange should turn against us and the danger of gold exports arise.

Sixth. The sentiment has been quite frequently expressed that we commit an injustice by permitting these low rates for bank acceptances when we could not or would not permit the same low rates for commercial paper. The difference between the two kinds of paper has already been pointed out. Furthermore it must be apparent that *we could*, of course, lower our rates for commercial paper but that we ought not to do so because such action would be unsound and dangerous. Incidentally, it might be well to consider that if we want to keep our machinery going and want Europe to continue to purchase without bringing about a depletion of gold holdings which might render it impossible for those countries to continue to buy of us, we have, to a certain extent, to provide the means with which Europe can pay.

Europe will either sell us back our own securities (which evidently she is not very much inclined to do for the present) or we may give Europe short-term credit facilities or buy her issues of securities. To invest our money in European long-term securities would not be advisable. The time has not yet come when this country can act as the world's banker and as a permanent investor in foreign securities. Moreover, for political reasons, it is not desirable that large public issues be made here for belligerent powers at this time. On the other hand, should we become the temporary banker of Europe, by granting these acceptance facilities—a banker who at any time on short notice can call back his funds—that, indeed, would be the safest and the most useful position for the United States in present circumstances.

Open-market transactions in domestic bills of exchange would have exactly the same effect as a lowering of our bank rates for commercial paper. They would in effect result in competition with the commercial banks in the purchase of commercial paper; such an invasion of their legitimate field of operation would force them to counter the stroke by underbidding us, or—as already shown—drive them into undesirable investments. The Federal reserve banks, by taking such a step, would invite the most bitter —and well-deserved—criticism.

While these two classes of open-market operations may appear to be very similar, careful examination will show that the open-market purchase of domestic "bills of exchange" would, at this time, weaken our general situation, while the purchase of bank acceptances drawn for foreign account to finance importations or exportations, would add an element of strength.

Seventh. There are now excess reserves of $500,000,000. A loan expansion has already taken place in the past few months of about $220,000,000. There is nothing but the sound common sense of the commercial banks that can prevent a further expansion which may reach an amount of over $1,000,000,000. The inverted pyramid is likely to grow, but the basis on which the entire structure stands, the reserves, has been reduced by the Federal Reserve Act. Every dollar that the Federal Reserve System puts out at this time further weakens these lessened reserves. The entire safety of the expanded situation rests on the Federal reserve banks. At a time when our usual European credit facilities have become unavailable, and when the European investment markets, on which we formerly relied to a certain extent, have been closed, the additional elasticity which our new system provides, is the only means of replacing what thus we have lost. It would appear the part of prudence and sound business judgment to husband our resources and not to increase, but rather to counteract, the ease of money which again will drive the banks into fixed investments. These always have proved to be their ruin after a time of great plethora. Within the next two years we must withdraw $200,000,000 from the banks and add this amount to our own resources. Until then, it will be advisable not to let the inverted pyramid grow to an extent which will render it extremely difficult to withdraw such funds. Even if European conditions were entirely normal it would be advisable in these first two years of growth to proceed cautiously. With conditions as they are, there cannot in my mind be any doubt as to our policy.

Trade does not follow the flag unless there is something behind the flag to fasten it to. Trade follows finance as often as finance follows trade. Present conditions—deplorable as they are in many respects—offer us a unique opportunity of establishing ourselves as a financial world power. Now is the time when "a

friend in need" is wanted in all parts of the globe; and when valuable relations can be established with foreign countries.

If we miss this opportunity, if we show hesitation and pettiness where boldness and statesmanship are required, if we cannot get beyond the distinctly local point of view, the European countries—when peace will be restored—will remain the masters of the situation as in the past. We cannot be a world power if we do not adopt the broad principle that we must be willing not only to take but also to give, just as other nations are willing to give us the advantage of their facilities whenever, and to the extent that, their own conditions permit. A banker who has the reputation of being essentially selfish will never secure a good class of customers. Our new system can rank with the Bank of England, the Reichsbank, and the Banque de France only if it be administered on broad principles of financial statesmanship and not like a country bank, which looks only to what it can earn and seeks to serve only the selfish interests of its immediate customers.

P. S. From the point of view of a Federal Reserve Board member—disregarding all other considerations which the government as a whole must weigh—a sale of United States Government bonds or short-term notes would just now have a most desirable effect, provided that the issue were sold to the public and the commercial banks, the proceeds being actually withdrawn and locked up in the Treasury. It must not be forgotten that the net cash lost by the Treasury during the past few months has gone into circulation and into the banks.

P. M. W.

APPENDIX THIRTY-FIVE

LETTER TO HON. JAMES G. STRONG, HOUSE OF REPRESENTATIVES, CONTAINING REPORT OF MERCHANTS' ASSOCIATION OF NEW YORK

May 24th, 1927

To the Board of Directors,
The Merchants' Association of New York

Gentlemen:

Your Committee on Banking and Currency recommends that the following letter be sent by The Merchants' Association to Congressman James G. Strong in reply to his letter of April 16th, 1927, on stabilization of the general price level:

Hon. James G. Strong,
House of Representatives,
Washington, D. C.

Dear Sir:

This Association appreciates the courtesy of your invitation, dated April 16th, to study your bill for the stabilization of the general price level and to give you the impressions derived from that study. The Association takes pleasure in communicating to you the following results of its thought and discussion upon the subject.

The Association shares the view universally held that the interest of the country is served best by the greatest possible stability of price levels, and believes that in fashioning their discount and open market investment policy, the Federal Reserve Board and the Federal reserve banks should ever be mindful of this aim.

The Association is conscious, however, of the fact that there is a multiplicity of influences at play in determining price levels. The influence of money and credit is only one of them and, again, while the Federal reserve banks—directly through their operations or indirectly by affecting the psychology of the people—are important

factors in increasing or decreasing the speed and volume of the flow of money and credit, they do not and cannot exercise a complete control of these currents. Any injunction to be imposed upon the Federal reserve banks, in the opinion of The Merchants' Association, could not, therefore, go further than to impress upon those in charge of the Federal Reserve System the desirability of making this ideal of price stability their compass by which to steer their craft as far as the impelling consideration of other immediate requirements and emergencies permits. It would be dangerous, however, to permit the fallacious impression to assert itself in the minds of the people that the Federal Reserve System (no matter how much its officers might bend their efforts in the direction of attaining price stability) could be held responsible for failure to attain this ideal which, as already stated, could only be reached by the coöperation under a common plan of forces entirely outside of the Federal Reserve System's control, not only in the United States, but all the world over. One need only envisage the drastic changes that would follow from the elimination of our tariff or immigration walls, or from the adoption of an inflationary policy on the part of our Treasury in order to realize the limitations of the scope of influence of central banks in this regard.

The Merchants' Association hopes that it is not presuming upon your patience in stating these views—no doubt fully familiar to you—but it cannot forego expressing its earnest concern lest by pledging the Federal Reserve authorities to the accomplishment of a task plainly beyond their powers, the door may be opened to attacks upon the Federal Reserve System by those who in the case of recurrent price level fluctuations, should they occur, would see a fiasco of the Federal Reserve System, or a willful disregard on the part of the Federal Reserve authorities of the injunctions laid upon them by the law. This might engender in the minds of people not well versed in the functioning of economic laws a feeling of disappointment and resentment which might lead to attempts to induce Congress to pass legislation far beyond the general direction contained in the draft of the law as sponsored by you; legislation that would endeavor to lay down specific instructions, dangerous because rigid rules cannot be devised adequately to meet so complex a problem as the economic structure of the world, and doubly

so because in all probability these instructions would have to be predicated upon theoretical charts and indices, the study of which is only in its infancy, and the reliability of which has not yet been adequately tested.

In case The Merchants' Association can be of any service to you in the solution of the complex problem on your hands, it will consider it an honor and a pleasure at all times to hold itself at your disposal.

Sincerely yours,

S. C. Mead, *Secretary*

Respectfully submitted,

Paul M. Warburg

Chairman, Committee on Banking and Currency

APPENDIX THIRTY-SIX

OPINION OF THE ATTORNEY GENERAL OF THE UNITED STATES CONCERNING THE POWERS OF THE FEDERAL RESERVE BOARD TO REGULATE DISCOUNT RATES OF THE SEVERAL RESERVE BANKS

DEPARTMENT OF JUSTICE

Washington

December 9th, 1919

DEAR MR. SECRETARY:

In response to your request for my opinion concerning the powers of the Federal Reserve Board to regulate discount rates of the several reserve banks, I reply as follows:

By section 14 of the Act of Congress, designated by the short title "Federal Reserve Act" (Act of December 23rd, 1913, 38 Stat. 251), it is provided that "every Federal reserve bank shall have power"—

(*d*) to establish from time to time, subject to review and determination of the Federal Reserve Board, rates of discount to be charged by the Federal reserve bank for each class of paper, which shall be fixed with a view of accommodating commerce and business.

By section 4 of said Act each Federal reserve bank is under the supervision and control of its own board of directors, subject, however, to the provision of section 11 of said Act which provides, in part, that—

"The Federal Reserve Board shall be authorized and empowered . . .

(*j*) to exercise general supervision over said Federal reserve banks." Said Federal Reserve Board is also further "authorized and empowered to examine at its discretion the accounts, books, and affairs of each Federal reserve bank . . . and to require such state-

ments and reports as it may deem necessary." (Sec. 11, subdiv. a)

By section 12 there is also created a Federal Advisory Council composed of representatives chosen in the manner prescribed in said section, which is to confer directly with the Federal Reserve Board. Among its powers it is authorized to "call for information, to make recommendations in regard to discount rates, rediscount business," etc.

The question for determination is whether, taking into consideration the language of section 14 (*d*), giving the power to the Federal reserve banks to establish from time to time rates of discount, "subject to review and determination of the Federal Reserve Board," and the further power of the Federal Reserve Board to exercise general supervision over said Federal reserve banks, the power of the Federal Reserve Board is limited to reviewing and approving or disapproving rates of discount made by such banks, or whether said Board may, in the exercise of its powers, from time to time review the rates of discount in use and direct specific changes and alterations thereof.

The legislative history of the Act shows that as originally drawn section 14, subdiv. (*d*) conferred the power upon the Federal reserve banks to make discount rates "subject to review" by the Federal Reserve Board, and that said section was amended in committee by adding the words "and determination" after the word "review," so as to make said section read as now enacted.

It is quite evident that if the Federal Reserve Board is confined to the power to review and approve or disapprove rates of discount made by the Federal reserve banks, and is without power to itself direct specific changes, the words "and determination" are wholly without significance. The very signification of the word "determination" used in such a connection, carries with it the right to pass upon and to decide and fix, and thus determine what should be done. Coupling this with the power given the Federal Reserve Board to supervise the business of each Federal reserve bank, taking also into consideration the recommendations contemplated by the Advisory Council to the Federal Reserve Board in regard to discount rates, such power would be futile if such Federal Reserve Board could not, if agreeing to such recommendations, direct them to be carried out. I think it is quite clear that

the Federal Reserve Board is the ultimate authority in regard to rediscount rates to be charged by the several Federal reserve banks and may prescribe such rates.

This is in all cases necessarily a review of rates existing at the time in the bank, and therefore strictly calls for the exercise of this power; the determination reached by the Board carries with it the exercise of the power of determination specified in sec. 14, subdiv. (*d*); and also exercises the power of supervision granted in sec. 11, subdiv. (*j*).

The scheme of the entire Act is to have Federal reserve banks in different parts of the country so that their operations may be accommodated to the business needs of each section, and to vest final power in the Federal Reserve Board, so as to insure a conduct of business by each bank which will not be detrimental to the carrying out of the entire plan. The powers of the Federal Reserve Board are therefore to be exercised in regard to each reserve bank as the conditions surrounding said bank may dictate, keeping in view the general purpose and plan of the Federal Reserve Act. Bearing in mind such general purpose, I am of the opinion that the Federal Reserve Board has the right under the powers conferred by the Federal Reserve Act, to determine what rates of discount should be charged from time to time by a Federal reserve bank, and under their powers of review and supervision, to require such rates to be put into effect by such bank.

Very respectfully,

ALEX. C. KING
Acting Attorney General

Hon. Carter Glass,
The Secretary of the Treasury,
Washington, D. C.

APPENDIX THIRTY-SEVEN

REMARKS OF THE AUTHOR, AS CHAIRMAN OF INTERNATIONAL ACCEPTANCE BANK, INC., MADE IN HIS ANNUAL REPORT, MARCH 7, 1929

In aeronautics the public is generally inclined to look upon the art of rising into the air as the sole accomplishment. The layman is apt to overlook the fact that the mastery of the art of descending is of equal, if not greater, importance. No central banking system may safely permit its facilities to expand unless it is certain of its determination and ability to bring about contraction when circumstances require. If Dr. Eckener had not been possessed of the unrestricted authority to shape the course of his "Zeppelin" according to the meteorological conditions he would meet, and to give his orders for landing within the fraction of the second that circumstances required, if he had not been certain of the prompt response of his engines and his crew, he never could have ventured to rise. Had his manoeuvers been dependent upon the directions of 120 men, acting through twelve separate boards of directors, and operating "subject to the review and determination" of a central board of eight men, who may be wide apart in their views and bewildered by political influences and attacks, his ship would have been wrecked.

Now, while it is obvious that we could not and should not give to one man, or to one single set of men, the wide autocratic powers that would assure the greatest efficiency in the administration of our central banking system, it is equally clear that, as at present constituted, the machinery governing its steering apparatus is too complicated to be either safe or efficient. The Federal Reserve System, pursuing a well-conceived and far-sighted policy, rose to a position of world leadership. Yet, within the short span of a year it lost that leadership, owing to its failure promptly and

effectively to reverse the engines at the critical moment. The rudder then passed into the hands of stock-exchange operators, who have now for many months governed the flow of money, not only in the United States, but in the principal marts of the world. History, which has a painful way of repeating itself, has taught mankind that speculative overexpansion invariably ends in overcontraction and distress. If a stock-exchange debauch is quickly arrested by prompt and determined action, it is not too much to hope that a shrinkage of inflated stock prices may be brought about without seriously affecting the wider circle of general business. If orgies of unrestrained speculation are permitted to spread too far, however, the ultimate collapse is certain not only to affect the speculators themselves, but also to bring about a general depression involving the entire country.

From the economic lessons taught by the aftermath of the Great War, we learned that the excessive creation of money or bank credit without an equivalent production of assets spells inflation. Yet the public mind does not appear to realize that the creation of an inflated purchasing power is not a monopoly enjoyed by governments. When we consider that the market value of the fifty industrial stocks, the twenty public utility stocks, and the twenty railway shares which are used in computing the Standard Statistics Company's index of the prices of stocks, has grown within two years from approximately $17,500,000,000 to $33,000,000,000, we find an accretion of approximately $15,500,000,000, an accretion, in the majority of cases, quite unrelated to respective increases in plant, property, or earning power. Yet this stupendous bulge in "value" covers only a limited number of corporations, and it does not include bank stocks, or some of the subtlest elements of inflation—incorporated stock pools, called "investment trusts." Nor does it comprise the gigantic enhancement of real estate values. One can only leave it to the imagination to guess the amount by which the inflation of values such as these exceeds the entire war debt of the United States. In order to grasp the vastness of the sums involved, it may be well to remember that the total value of our cotton, wheat, and corn crops combined would amount to approximately $4,000,000,000. There

are those who claim that the increase in the market value of our securities is warranted by their intrinsic value. One might be more inclined to agree with that view if the present level of our stocks were not sustained by a colossal volume of loans carrying unabsorbed securities, of which $6,000,000,000 of brokers' loans form only a part, and if the banking structure carrying this inflated inverted pyramid did not rest on a basis of Federal Reserve credit, which in these last two years has been stretched by an increase in the earning assets of about half a billion dollars over what used to be their approximately normal size. Conditions such as these recall to our minds the painful events of the years of 1919–21. Yet the parallelism between that period and the present does not seem to be properly appreciated by the general public on account of the fact that billions of dollars poured into the stock exchange by domestic corporations and from across the seas are not revealed by the barometer indicating the Federal Reserve System's condition and because the index does not register the same striking rise of commodity prices shown in the inflation period of 1919 to 1920. It should be remembered, however, that in those years there prevailed a shortage of commodities and a passionate demand for them, while at present the world is craving for the ownership of shares and for the satisfaction of new wants. Nobody would object to a fulfillment of these desires so long as the necessary funds were provided from savings. But when the savings of the masses are deposited as margins for stock-exchange speculations, and when the extravagant use of funds for speculative purposes absorbs so much of the nation's credit supply that it threatens to cripple the country's regular business, then there does not seem to be any doubt as to the direction in which the Federal Reserve System ought to exercise its influence quickly and forcefully. People who express the fear that increases in the Federal reserve banks' rediscount rates might hurt business overlook the far greater hurt the country will have to suffer if their advice to permit the situation "to work itself out" were followed. Moreover, for approximately the last six months we have had, in effect, a bank rate of 7 or 8 per cent; for it is that rate which during that period has directed the flow

of gold to our shores and which has exercised a decisive influence in the fashioning of our domestic rate structure. When commercial paper commands 5¾ per cent, and when bankers' acceptances sell at 5⅜ per cent, rediscount rates of 4½ per cent and 5 per cent seem grotesquely impotent and out of line. Procrastination in bringing such rediscount rates into a proper relation to actualities, hesitation in taking effectual means to reassert the Federal Reserve System's leadership, place a grave responsibility on those in charge of its administration. It is true that our inability to develop a country-wide bill market and our failure to establish on our stock exchange a system of term-settlement dealings aggravate the difficulties of our problem. But these defects of our system render the need for determined leadership all the more imperative. That the country's banking system is tossing about to-day without its helm being under the control of its pilots gives cause for deep concern. Yet, the fault does not seem to lie so much with the men in charge of it as with the structural defect of its administrative organization. The banking fraternity would be well advised to anticipate radical Congressional proposals by taking the lead in seeking the lines along which reform may be brought about.

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